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Baltic Newsletter

Law and Taxes in Estonia, Latvia and Lithuania
Issue: October 2017

Read in this issue

- > Targeting: New CIT model in Latvia from 1 January 2018
- > Update: Tax overhaul in Estonia
- > Focus: Investment Conditions in the Baltic countries – Investment-friendly tax systems and Free Economic Zones

News in brief

- > Estonia:
 - Estonia's ratification of the Agreement on a Unified Patent Court in force
- > Latvia:
 - Several important changes to the Commercial Law of Latvia
 - Natural and legal persons' account register
 - Amendments to the Employment Law
- > Lithuania:
 - Proposal to give shareholders easier access to a company's confidential information
 - Amendments to Lithuania's Law on Public Procurements
 - Amendments to Lithuania's Law on the Prevention of Money Laundering and Terrorist Financing

Internal

Dear Readers,

Estonia, Latvia and Lithuania are among the most dynamic economies in the EU in 2017. According to estimates by their national statistics offices, gross domestic product (GDP) rose by 4.1 per cent in Latvia and 3.9 per cent in Lithuania in the second quarter of 2017. Analysts expect a similar picture to emerge in Estonia. In addition to higher consumer spending and increased gross fixed capital formation, all three Baltic states continue to benefit from their improved international competitiveness in the wake of the 2008 crisis.

Although there are different tax systems and economic incentive schemes in the three countries, each is showing a like-minded approach to stimulating growth. Latvia's parliament, the Saeima, has recently approved tax reforms that mean corporate income will no longer be taxed until profits are distributed. Estonia already has a similar corporate taxation system in place.

In addition, all three Baltic countries are increasingly focusing on Free Economic Zones (FEZ) and are constantly developing them into economic hotspots that have demonstrated their potential to revitalize whole regions. The FEZ Kaunas (Lithuania) is a notable success story having recently made positive headlines for becoming the largest automotive location in the region – not least through a major investment by HELLA, one of the world's leading automotive suppliers. Remigijus Šimašius, the Mayor of Vilnius, has talked up the possibility of establishing a FEZ near the Lithuanian capital Vilnius. The proposed Vilnius FEZ would provide yet another substantial boost to the Lithuanian economy and enhance its reputation as an attractive place for investment.

We would like to use these exciting developments as an opportunity to take a closer look at investment conditions in the Baltics and, in particular, the issue of Free Economic Zones. We will also explore and explain the new corporate income tax (CIT) law in Latvia that is due to enter into force on January 1st, 2018.

I hope that you will find it valuable reading,



Tobias Kohler
Partner, Head of Office Lithuania

> Targeting: New CIT model in Latvia from 1 January 2018

Elina Putnina, Rödl & Partner Latvia

In brief:

- > A new CIT model will be introduced in Latvia that means only distributed profits are subject to tax.
- > A transitional period will allow taxpayers to use tax relief based on the current tax system.
- > A progressive personal income tax (PIT) system will also be introduced in Latvia.
- > Tax payers should prepare themselves for the new tax regime which will be in force starting 1 January, 2018.
- > The current corporate income tax will be applied only on a profit, which has been earned in a period until 31 December 2017.

Tax reform in Latvia

In order to stimulate foreign investment in Latvia and to provide extra incentive for companies to invest in the country, a new CIT model has been adopted which means that, henceforth, only distributed profits will be subject to taxation. The new CIT Law comes into force from 1 January 2018.

Significant amendments to PIT Law were also adopted, the main change being the introduction of a progressive PIT regime and increase in PIT for capital gains.

New CIT model

As of 1 January, 2018, the newly amended CIT Law will come into force, heralding a completely new approach to corporate taxation.

The definition of a taxpayer has been broadened and will now include not only share capital companies, but also partnerships that were previously tax-transparent and which settled their tax obligations by their partners.

New definition of taxable objects

The taxable object has been changed under the new law. Previously, profits were subject to tax, whereas from now on tax will have to be paid for:

- > Calculated dividends, including interim dividends
- > Profit payment to members of a cooperative society
- > Division of profits of an individual entrepreneur (including a farmer or farm)

- > Distribution of profits of a partnership (excluding investment funds established as partnerships)
- > Payments of a non-resident's permanent establishment to its non-resident company
- > Distribution of conditional dividends where profit is used for increasing a shareholder's contribution

The obligation to pay tax also applies in the following cases (and the tax is payable even when a given taxpayer incurs losses in the current financial period):

- > Expenses that are not related to commercial activities
- > Interest payments on excessive debt obligations
- > Loans issued to related persons (with certain exceptions)
- > Income and expense corrections due to the application of transfer pricing adjustments

Taxable base and tax rate in case of distributed profits

For the calculation of a taxable base of a given taxation period, a taxpayer shall divide the taxable object with a coefficient of 0.8.

Once adjusted accordingly, the taxable base is then subject to a tax rate of 20%, which means that the effective tax rate is 25% (caused by dividing the taxable object with a coefficient of 0.8).

The current corporate income tax will be applied only on a profit, which has been earned in a period until 31 December 2017. If a shareholder is a natural person, it should be taken into account that the personal income tax rate of 10% will apply to this profit only in cases where the profit is being distributed in 2018 or 2019. If the profit is being distributed later, the personal income tax rate of 20% will apply to the distributed profit.

The CIT return shall be filed and the tax shall be paid by the 20th of the month following the month in which a taxable event occurred. The taxation period is, therefore, a calendar month.

A transitional period will be introduced for the first tax report which can be prepared for the period from January until June 2018, and submitted by July 20th, 2018.

If a taxpayer's financial year differs from a calendar year, the tax payer for the period until December 31st, 2017 must submit an interim financial report and tax report for the tax calculation. Separate reports will have to be submitted for the period from January 1st, 2018 until the end of the financial year.

Payments to non-residents

As before, the Law sets forth that non-resident income paid by Latvian residents or permanent establishments of non-residents in Latvia is subject to tax. Tax shall be withheld from:

- > Income from the provision of management and consulting services at a rate of 20%, instead of 10%, which is applicable until the end of 2017;
- > Income from the alienation of real estate in Latvia at a rate of 3%. The tax rate has been increased by one percentage point on 2%.

For EU residents or those from countries with which Latvia has a taxation treaty in force, the law provides for the right to submit a report on related expenses for the income in question and pay tax only on acquired profits.

Furthermore, the currently applicable withholding tax on any payments made to low tax or zero tax jurisdictions remains in force and, as of 1 January 2018, a 20% withholding tax will be applicable to any such payments.

Deduction of dividends and exemption for capital gains

The taxable base may be reduced for the amount of dividends received from subsidiary companies that are subject to CIT in their country of residence or in cases where a withholding tax was levied on such dividends.

The taxable base may also be reduced for the amount of capital gains resulting from the alienation of shares of a direct subsidiary that have existed for a period of at least 36 months.

Use of accumulated losses for CIT purposes from previous years

A transitional period for the use of accumulated tax losses from previous years (for CIT purposes) has also been introduced. It will now be possible to use the accumulated losses declared in a CIT declaration to decrease the tax payable for distributed dividends for 5 years in the following manner; it will be possible to decrease the tax payable in the amount of 15% of accumulated losses for tax purposes, but not exceeding 50% of the calculated tax for the distribution of dividends in a given year. If all accumulated losses for tax purposes have not been used, it will be possible to use the remaining sum in other financial periods.

Tax relief

Henceforth, taxpayers will be entitled to tax relief when they make donations to public benefit organizations and other institutions to the tune of the following amounts. Taxpayers are entitled to choose one of the following reliefs:

- > donations which do not exceed 5% of profit of a previous financial year are not included in the taxable base
- > donations which do not exceed 2% of a gross work salary are not included in a taxable base; fund of a previous financial year
- > decrease a tax payable for distributed dividends for the amount of 75% of the donated amount, not exceeding 20% of the calculated tax

The new law provides for a transitional period for tax reliefs for large investment projects which have been approved until 31 December 2017.

Amendments to PIT law

Significant amendments to PIT law were also adopted by the Latvian parliament. As of 1 January 2018, a progressive PIT system will be introduced at the following rates:

- > 20% for annual income not exceeding 20,000 euros;
- > 23% for annual income exceeding 20,000 euros but not exceeding 55,000 euros;
- > 31.4% for annual income exceeding 55,000 euros.

A flat PIT rate of 23% used to apply to everyone.

PIT applicable to capital and capital gains will be increased to 20%. PIT will not be levied on dividend income and other profit distributions, where:

- > CIT levied on distributed profits is paid in Latvia;
- > CIT is paid in a foreign country or PIT is withheld by a foreign payer from dividends or distributed profits.

A two-year transitional period (covering 2018 and 2019) foresees a 10% PIT rate on the distribution of profits accumulated until 31 December 2017.

Advice:

- > Amending internal procedures and IT systems so that they comply with the new regulations.
- > Multinational groups of companies which have accumulated losses in Latvia should research how the losses can be utilized in the most efficient way.
- > Companies whose shareholder is a natural person should evaluate the need to distribute an accumulated profit within the two successive years. In this case a personal income tax rate of 10% will be applied to the distributed profit. If the profit is being distributed later, a tax rate of 20% will be applied;
- > Evaluating a transfer pricing policy. Corrections of transfer prices can create an additional payable tax, and most likely the tax administration will pay more attention to this topic.
- > We will be glad to help you prepare for the new tax regime. Please note that the new regulations are applicable from 1 January 2018. We highly recommend undertaking the measures we have described.

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> Update: Tax overhaul in Estonia**Verner Silm**, Rödl & Partner Estonia**In brief:**

- > On 19 June 2017, the Estonian Parliament passed amendments to the Income Tax Law (and other laws) and introduced new regulations to simplify taxation and the declaration of business income for natural persons (see Baltic Newsletter, July 2017).
- > On 29 June 2017, the Estonian President Kersti Kaljulaid signed and announced a large part of these tax regulations, but rejected some regulations since she deemed them to be unconstitutional.
- > Although the new Estonian government has announced a long-term transitional period, companies should already start preparing for the changes in order to leverage new opportunities and eliminate risks before the law enters into force.

Estonian CIT

At long last a new income tax system for businesses has been adopted. This means that profits distributed in the calendar year, which are equal to or less than, or equal to the average profits distributed over the previous three calendar years, will be taxed at a rate of income tax of 14%. In the case of dividend distribution, the taxable amount is divided by the amount of 0.86 before multiplying the tax rate.

Dividends exempted from income tax and income tax exempted profit distributions, or taxable profit ("pledge income tax"), are not taken into account for the calculation for the average distributed profits (three calendar years). Furthermore, an income tax rate of 7% will be levied on all dividends as well as other dividends distributed to a resident natural person from a resident company in monetary or non-monetary distribution form, only, however, if these payouts are taxable for a company and are not regarded as fringe benefits. The new income tax system does not change for natural resident persons (as ultimate beneficial owners), but is aimed instead at favouring foreign investment (20/80 vs. 14/86).

Pledge income tax

Pledge income tax was previously listed as a tax in Baltic Newsletter, which the Estonian government was set to completely do away with in its tax package for the year 2017/2018. At the last moment, however, the government backtracked and passed a simplified version of the pledge income tax system.

A resident company pays CIT on a loan given to a shareholder or member of the company if the circumstances of the transaction indicate that this might involve implicit profit allocation. The resident company is obliged, at the request of the tax authority, to provide information (the Estonian tax authority is working out a new regulation that will determine how to interpret loans) showing that a parent company or subsidiary of the same parent company (with the exception of the lender's subsidiary) intends to repay the loan in question and has the ability to repay the loan to the resident company where the repayment period exceeds 48 months. The tax authority will give a resident company 30 days to fulfil its obligation of providing the necessary information.

According to the new tax system, a parent company is a company which is structurally above the company that provided the loan (this can include non-profit organizations and foundations). Entities that have a majority or dominant influence in the lending company are also considered a parent company.

Thus, the taxpayer does not have to pay the pledge tax immediately (according to the draft law, income tax had to be paid the following month), but the need to grant a loan and the ability to repay it must now be demonstrated.

Procedure for the taxation of company cars (fringe benefits)

The new system was adopted as described in the previous Baltic Newsletter. Here is a reminder of how it works: for the use of professional, occupational or service vehicles that are owned or operated by the employer, the fringe price is 1.96 euros per month in connection with the engine power unit (kW) indicated in the traffic register. In the case of vehicles that are more than five years old, the fringe price is lowered to 1.47 euros.

There are no tax-related fringe benefits if the vehicle has been temporarily removed from the traffic register or if the registration is suspended.

In cases where an employer, who owns a vehicle or is its responsible user, does not allow the use of a vehicle for non-business-related purposes, he or she has to notify the Estonian Road Administration, upon acquisition of the vehicle, that the vehicle will only be used for official (i.e. work or business-related) purposes.

Sweetened beverages tax

The government had hoped to introduce a sweetened beverages tax from 1 January 2018. However, its adoption has been delayed because of legislative timing problems. At least six months must pass between the adoption of a law and its entry into law, but President Kersti Kaljulaid did not declare the proposed beverages tax at the beginning of July as planned.

Although the president supported the idea of the tax as a measure to reduce sugar consumption, it was found that the law would unfairly benefit those companies which would be exempt from the sweetened beverages tax. This, in turn, would create an uneven playing field, something contrary to the spirit of equal advantage in business.

In its current form, the sweetened beverages tax will affect manufacturers of dairy products and natural juices, among others. The treasury department wants to exempt these groups from the proposed tax. In order to achieve this, Estonia has applied for an exemption from the European Commission.

The Ministry of Finance submitted a pre-proposal for state aid to the European Commission on 22 June 2017. After receiving feedback from the European Commission, and following numerous consultations, a formal application will follow the pre-application. The European Commission has two months to reach a decision, during which time it can request additional information from the government to make its case and clarify its position. At the time of writing, the two-month period has almost passed and the European Commission has still to reach a decision regarding the issue.

Advice:

- > The Estonian government will continue working on its legislative program, including the sweetened beverages tax. Manufacturers of such beverages should be prepared for the forthcoming legislative changes.
- > The above obligation to communicate the need and repayability of loans shall apply retroactively to loans granted from 1 July 2017 and to loans extended after 1 July 2017 (the extension of the duration of the loan or modification of other circumstances). Companies should therefore review whether any loans granted by or to them correspond to the above criteria.
- > The new fringe benefits system for company vehicles only applies to M1 category vehicles with a gross weight not exceeding 3,500 kilograms and with no more than eight seats in addition to the driver's seat. The transportation of employees between their place of residence and employment under the conditions provided in the Income Tax Act is also deemed to include the use of an automobile for business purposes. Therefore, companies should evaluate their car fleet and its uses to make the best use of the new regulations.
- > Should you have any questions or require more information, Rödl & Partner will gladly be your consultant on any tax-related issues.

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> Focus: Investment Conditions in the Baltic countries – Investment-friendly tax systems and Free Economic Zones

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In brief:

- > Each of the three Baltic states has different tax systems and economic incentive schemes.
- > Tax incentives, funding programmes and FEZs are attracting high levels of investment but there are significant differences as to how this works in practice.
- > Rödl & Partner, with 20 years' experience in assisting foreign investors in the Baltic states, can help you develop the optimal investment strategy for your company.

Ideal conditions for foreign investors

Due to the relatively small size of their respective national markets, the Baltic states are often viewed as a single economic area. However, in reality they are three distinctly different legal entities, each with its own unique characteristics. The financial crisis had a major impact on all three countries, hitting them with devastating force. Their growth levels collapsed, which in turn resulted in a 20% reduction in wages. To rectify the situation, all three countries sought to increase levels of foreign investment. But Estonia, Latvia and Lithuania found, with the help of the European Union, very different solutions as to how to go about achieving this.

This is why we find significantly different tax systems and economic incentive schemes throughout the Baltic states. Moreover, each country has differing economic priorities.

Estonia is well-known as a digital pioneer in Europe. Among other innovations, it uses the e-Residency ID card, which gives foreigners a state-guaranteed digital identity and allows them the use of numerous e-government services from abroad. Business start-ups and dealing with the authorities are made easy and accessible in this way. Likewise, Estonia's innovative tax system is an impressive example of streamlining bureaucracy to facilitate doing business.

Equipped with new EU funding, Latvia's economic development will once again gain momentum in 2017, according to forecasts by numerous economists from the Latvian Ministry of Economics, the Central Bank, the European Commission, Swedbank, Nordea and SEB. Growth drivers are gross fixed capital formations, particularly in the construction sector.

In 2017, Lithuania strengthened its position as the most attractive investment location in Europe for shared services centers and business process outsourcing. Cushman & Wakefield's 2016 "Business Process Outsourcing and Shared Service Location Index" rates Lithuania highly with regard to its economic conditions. Furthermore, Lithuania has also become an automotive hub. More than 400 indirect automotive suppliers in Lithuania generate a turnover of over 400 million euros. This is boosted by the Baltic Automotive Components Cluster (BACC), which unites medium-sized German, Swedish, Norwegian and Lithuanian companies operating in the Baltic states. The Kaunas Free Economic Zone has recently become a prime production location for HELLA, one of the biggest automotive parts suppliers in the world.

In the 2017 World Bank report "Doing Business", which assesses the ease of doing business on the basis of various factors, Estonia, Latvia and Lithuania all rank in the top 25 (Estonia – 12; Latvia – 14; Lithuania – 21). The low wage levels in all three countries certainly works to their advantage. The official average monthly wages are currently:

- > Estonia – 1,153.00 euros (gross)
- > Latvia – 886.00 euros (gross)
- > Lithuania – 808.70 euros (gross)

All three countries have Bilateral Investment Treaties (BIT) with several of the largest economic nations in the world, including Germany. BITs are international treaties between states which provide legal protection for direct investments by foreign individuals or legal persons (e.g. companies) in a foreign country, safeguarding against things like property expropriation. BITs include the following principles:

- > Non-discrimination principle – foreign investors shall not be treated worse than domestic investors or investors from third countries.
- > Protection function – investment protection agreements protect investors against unfair treatment and guarantee compliance with international minimum standards.
- > Dispute resolution – in the case of disputes, an international arbitration court may be established, in addition to national courts, such as the ICSID1 (New York) or the SCC2 (Stockholm).

The Baltic states have enshrined these principles in law to ensure the equal treatment of foreign investors and domestic enterprises. Foreign companies may be established in all three countries and/or hold up to 100% of them.

Tax situation

Successful foreign investment largely depends on the host country's tax conditions. Careful planning must take into account all the relevant provisions, taxes and duties. The investor should have two objectives in mind: first, to know and comply with all relevant tax obligations in order to avoid penalties or sanctions; second, to take advantage of any preferential tax rates or tax breaks that may exist in order to lure foreign investors.

Overview 1 – Corporate Income Tax (CIT)

	Estonia	Latvia	Lithuania
Standard rate	There is no real CIT because reinvested profits or retained earnings are not taxable. Distributed profits are treated as the income of private individuals with a flat tax rate of 20%.	Until 1 January 2018: 15% As of 1 January 2018, reinvested profits or retained earnings are not taxable. The taxable object in case of distributed profits is divided by 0.8 and a flat tax rate of 20% applies.	15%
Reduced rate		For micro-companies, a tax rate of 15% applies to revenues. This includes companies whose annual revenue is no greater than 40,000 euros and which have no more than 5 employees.	Micro-companies (up to a maximum of ten employees with revenues of up to 300,000 euros per year) are subject to a CIT rate of 5%, provided that no exceptions apply.

Overview 2 – Value Added Tax (VAT)

	Estonia	Latvia	Lithuania
Standard rate	20%	21%	21%
Reduced rate	9% on books, hotel accommodation and medical aid	12% on pharmaceutical products, baby products, newspapers, magazines and textbooks, as well as water and other utility services	9% on books and recurring publications, 5% on medicines and medical aids to persons who have a right to full or partial reimbursement of the costs of acquiring these goods
Small business scheme	Companies with annual revenues of 16,000 euros or more are obliged to register VAT. Voluntary registration is possible at any time.	The threshold for the application of the small business scheme is 40,000 euros.	The threshold for the application of the small business scheme is 45,000 euros, but these companies can register voluntarily.

¹ International Centre for Settlement of Investment Disputes

² The Arbitration Institute of the Stockholm Chamber of Commerce

All three countries have Double Taxation Agreements with all major industrial nations, including Germany.

Tax breaks

The Estonian income tax law supports investment through the abolition of CIT on reinvested profits. There are no special further advantages for foreign investors.

A new CIT model will come into force in Latvia starting from 1 January 2018. Reinvested profits will no longer be taxed thereafter; only distributed profits will be subject to taxation.

In Lithuania rebates exist in the following cases:

- > Companies investing in R&D can deduct three times their costs from the calculation basis for CIT.
- > According to an incentive for investment programs, companies can cut their CIT by up to 50% until 2018 regarding certain costs.

Funding Programs

EU Structural Funds

Like all EU countries, the Baltic states receive funding from EU Structural Funds for company-related regional and labour market development. The maximum grant is determined by the EU subsidy right, depending on the region and the size of the company, and limits the sum of all financial subsidies by the state, region and municipality. The following conditions apply:

- > The actual funding is defined by programs
- > Applications for funding shall be submitted to national authorities

Funding by the European Free Trade Association (EFTA)

The EFTA and Norway launched funding mechanisms, available from 2014 to 2021, to issue grants totalling 2.8 billion euros to 15 countries. The aim of the grants is to help adapt economies and institutional structures to EU standards. The focus is on climate and environmental protection as well as sustainability and social development, e.g. issues of gender equality.

- 1 A sum of 44.6 million euros is available to Estonia for the above period. Estonia has twelve different programs coordinated by several agencies, among others Enterprise Estonia, the Open Estonian Foundation and SA Archimede.
- 2 A total of 102.1 million euros is available to Latvia for the above period. The Investment and Development Agency of Latvia (LIAA – Latvijas Investīciju un attīstības aģentūra) is responsible for overseeing the use of structural funds.

- 3 A total of 117.6 million euros is available to Lithuania for the above period. The Central Project Management Agency (Centrinė projektų valdymo agentūra) is responsible for the management of financial support funds from the EU and international financial institutions.

Promotion of small and medium-sized enterprises (SMEs)

The promotion of SMEs in the Baltic countries largely comprises the use of EU structural funds. To support SMEs, the three countries can also get support from the EU programs COSME and Horizon 2020.

COSME

The objectives of COSME include facilitating access to finance for SMEs and creating a favorable environment for business start-ups and expansion. The focus of this initiative is the promotion of entrepreneurial culture in Europe, increasing the sustainable competitiveness of European enterprises and supporting SMEs in their expansion abroad and improving their access to markets. COSME has a budget of 2.3 billion euros. The beneficiaries of the program are enterprises, in particular small and medium-sized enterprises (SMEs), as well as public and private players active in the field of enterprise promotion. The program is implemented on the basis of annual work programs drawn up by the European Commission. These define the priorities, measures, participation requirements and participation rules.

Financial support for enterprises is provided through so-called financial intermediaries or by means of specific calls for proposals, which are published in the Official Journal of the EU and on the Internet. Direct application by companies is not possible under the program except for technology marketing and demonstration projects.

Tenders for networking projects and analysis are aimed in particular at innovating public and private stakeholders, but companies may also apply for funding.

Horizon 2020

Horizon 2020 is an EU funding program for research and innovation, launched by the European Commission to be operational from 2014 to 2020. Horizon 2020 unites existing research framework programs with the Competitiveness and Innovation Framework Program (CIP), as well as the programs of the European Institute for Innovation and Technology (EIT). The merger resulted in a significantly higher provisioning of 79.271 billion euros, which has been available to the program since 2014.

Proposals for projects (i.e. applications for the promotion of research and innovation) can only be submitted in the framework of an open invitation to tender. The electronic participant portal (Participant Portal) provides an overview of all tenders. Everything from preparing an application,

concluding contracts and implementing projects is done through the participant portal. All the necessary documents, as well as access to national advice centres, can be obtained through the participant portal.

Special funding programs in the Baltic states

Estonia

Regional development centers were established in 2003 in the country's administrative regions, although they are now called development organizations. There are 15 such organizations throughout the country.

The Rural Development Fund (Maaelu Edendamise Sihtasutus) exists to support the development of rural areas. It supports farmers and other SMEs in rural areas through credit guarantees and loans.

Loans, equity and credit guarantees for investment projects are granted by the Credit and Export Guarantee Fund (KredEx). SMEs that were founded less than three years ago are eligible for support. Applications must be submitted by the (Estonian) bank of the applicant. The maximum amount of a loan is 64,000 euros.

The capital city of Tallinn has launched its own financial incentives for the purpose of job creation.

Up to 5,000 euros	At least 2 new jobs
Up to 10,000 euros	At least 3 new jobs
Over 10,000 to 20,000 euros	At least 5 new jobs

The new full-time jobs must be created within 6 months of the signing of the contract between the recipient of the grant and the Tallinn Enterprise Board, and the jobs must last for at least 3 years.

In addition, Tallinn has set up a number of industrial and commercial parks as part of its general corporate support.

Latvia

State guarantees

The existing Latvian guarantee agency was merged with two other institutions on 15 April 2015, to become the state-owned development finance institution ALTUM. It offers loan guarantees, leasing guarantees and venture capital for SMEs from different target groups. The aim of the credit guarantees is to provide access to financial resources for entrepreneurs (registered in Latvia) for business development by receiving loans in situations when their own collateral is insufficient to attract the necessary amount of credit or the business is considered too risky to receive funding from banks.

Credit guarantees cover up to 80% of the financial service, but a single enterprise cannot receive more than 1,500,000 euros. Guarantees are issued by ALTUM.

Co-Financing (Mezzanine) Loans and Micro Loans

A co-financing (mezzanine) loan can be used to cover investment expenses related to the diversification of products or services, extending existing capacity or fundamentally changing the production process, as well as setting-up a new establishment.

The maximum amount of a co-financing loan is up to 5 million euros and cannot exceed 45% of the total cost of the project (for loans from 2 million to 5 million euros, the maximum amount cannot exceed 35% of the total cost of the project). The minimum amount is 50,000 euros.

The maturity of a co-financing loan is up to 15 years for investment projects related to the acquisition, construction or reconstruction of real estate. For other investment projects, the maturity of the loan is up to 10 years.

These loans are issued by ALTUM.

Labour-related incentives

Labour-related incentives play a significant role in finding the best personnel and training them. Labour-related incentives are particularly important for businesses in labour-intensive industries. There are two agencies in Latvia offering labour-related incentive programs.

Vacancy registration and employee selection is performed by the State Employment Agency. It includes free-of-charge vacancy registration and employee searches utilising an enormous CV/Vacancy data base, and provides access to the EU database EURES. It offers support in finding suitable candidates and assistance in the first step of selecting potential employees.

The State Employment Agency also offers training for the unemployed (at the employer's request) for professions in high demand. The employer shall undertake to employ the trained person(s) for at least 6 months after the training has been completed. There is no limit on the number of unemployed people participating in training. The maximum cost for the training of a single unemployed person depends on the program and their qualifications; it generally varies from 355 – 1,547 euros.

The State Employment Agency offers the following support for companies, self-employed persons and associations/foundations:

- > A grant of 50% of an employee's monthly salary to employers who employ unemployed persons from vulnerable groups (EU structural fund co-financed program):
 - the grant cannot exceed the national minimum monthly salary

- the grant is paid for a maximum of six months.
- > A monthly grant to employers who employ disabled unemployed persons (state co-financed program):
 - a grant of 100% of the national minimum monthly salary for each disabled person employed
 - a one-time grant for the acquisition of the equipment and facilities to adapt the workplaces for the disabled unemployed persons
 - the costs of the services of any necessary sign language interpreters, companions, occupational therapists
 - the grant is paid for a maximum of a two year period.

Lithuania

Loans and labour-related incentives by INVEGA

UAB "Investicijų ir verslo garantijos" (INVEGA) is tasked with facilitating access to finance for SMEs. It offers, among other things, reduced financing conditions and credit guarantees:

- > the loan guarantees cover up to 80% of a loan. If the company has been active for less than three years, an upper limit of 579,240 euros applies. If the company has existed for longer than three years, the upper limit is 1,448,100 euros.
- > the fund, in conjunction with commercial banks, offers SMEs low-interest loans.

INVEGA is also responsible for the management of the "Support for the First Job" program. Employers receive a subsidy of 23.3% of gross income for the employment of new workers between 16 and 29 years of age who have not yet had any work experience.

Free Economic Zones (FEZs) and regional development centres

Estonia

Estonia has a total of three Free Ports: Muuga (Tallinn), Paldiski and Sillamäe. In addition, there is also a Free Trade Zone (FTZ) in Valga. Within these four FEZs, companies are exempted from VAT, duties and taxes on transit traffic. Moreover, the Estonian speciality – no CIT on reinvested profits – applies to all these zones.

Goods in the FEZ are considered as being outside the customs territory. Goods brought to the free zone for later re-export are not subject to VAT, excise or customs duties:

Taxes/Payments	FEZ	Regular rate
VAT	0%	20% or 9%
Duties	0%	Depending on goods

Another significant advantage is the reduction of the administrative burden in FEZs. Services in FEZs, on the other hand, are subject to regular taxes.

All FEZs in Estonia are open to foreign direct investments.

In order to store or manufacture goods at an FEZ, a company must obtain prior permission from the Estonian Tax and Customs board by applying through the electronic system LUBA (part of the E-tax board/E-customs system).

The availability of land plots for lease in the FEZs and all other relevant information can be obtained from the websites of the Port of Tallinn and the Port of Sillamäe.

Latvia

There are five FEZs in Latvia: the Free Ports of Ventspils and Riga, and the free zones of Liepāja, Rezekne and Latgale. Benefits for companies operating in these Free Ports and SEZs include rebates on real estate tax, CIT, and withholding tax for dividends, management fees and payments for the use of intellectual property for non-residents. Companies established in FEZs enjoy advantages in infrastructure and transport connections, benefit from a highly qualified workforce, and profit from favourable legal and tax regimes.

The most important tax rebates are:

- > 80% on CIT payable for distributed dividends
- > up to 100% on real estate tax

These tax benefits cannot be more than 35% of the amount invested (for SMEs the amount is 45 to 55%).

Companies operating in the territory of a Free Port or FEZ have the right to decrease CIT payable for distributed dividends if the following preconditions are fulfilled:

- > Investment lasts until 31 December 2035
- > Permission to apply for direct tax relief is granted throughout the existence of the support scheme

In cases where payments are made to a company that is using tax rebates under Free Port and FEZ regulations, tax is withheld from the payment (as with payments made to non-residents) at the following rates:

- > For management and consulting services, a rate of 20% applies
- > For the sale of Latvian real estate (or from the sale of shares of a real estate company), a rate of 3% applies

A company operating in a Free Port or FEZ that receives such payments has the right to deduct income-related

expenses and pay CIT only from its profits, thereby decreasing the withheld tax.

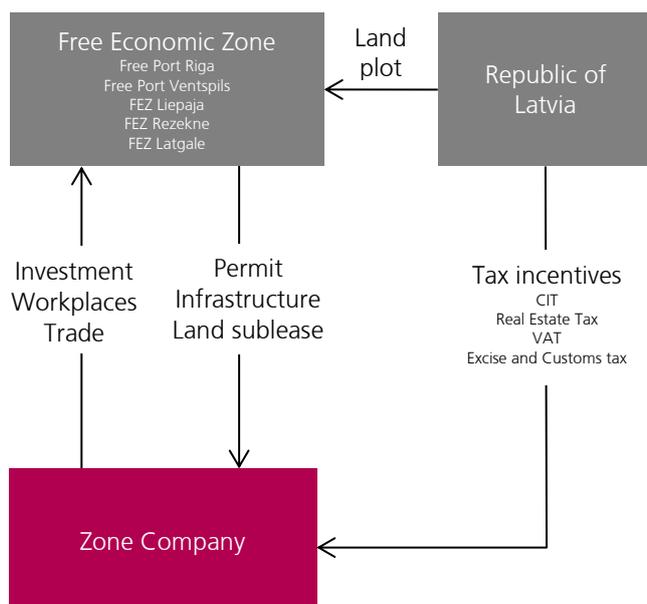
All FEZs in Latvia are open to foreign direct investments.

How to become a “Zone Company” in Latvia?

In order to set up a company in a FEZ, the client will need to establish a company by registering it in the commercial register and then submit an application to the zone’s authorities, including the following documents:

- > a registration certificate
- > articles of association
- > annual reports from the previous 2 years (if available)
- > a planned investment schedule

The company’s registered address and its actual place of business activity have to be within the territory of the FEZ. A company must own or have a long-term lease agreement for a land plot in the FEZ. A company’s business activities must meet the following criteria: the produce of goods, provision of services, or cargo turnover in the port, investment in property and long term assets, the creation of new workplaces, and the payment of salaries which are not lower than the average salary at the respective location. The activities of the investor shall comply with the laws of the FEZ and the profile of the company must comply with the development plans of the FEZ. The investor must obtain all necessary permits and licenses required to operate within the FEZ. However, permits and licenses can be suspended or revoked for violating the terms of the contract.



Permission for establishing a company within an FEZ is granted by the entity that manages the FEZ. This entity evaluates the application and grants or denies permission to establish or move a company to an FEZ. The evaluation

of an application is undertaken on a case-by-case basis according to the following criteria:

- > the amount of planned investments
- > the number of jobs created
- > salary levels
- > transfer of technology
- > volume of trade generated
- > planned utilisation of local resources

The management entity refuses to grant permission if the investor does not meet the above requirements or if the respective land plot in the FEZ has already been allocated to other investors and there is no possibility to assign another plot.

Lithuania

Lithuania’s seven Free Economic Zones are located in the economic centres of Akmenė, Kaunas, Klaipėda, Panevėžys, Marijampolė, Kėdainiai and Šiauliai, and provide unbeatable conditions for developing businesses by offering ready-to-build industrial sites with physical and/or legal infrastructure, support services, and tax incentives.

In all seven FEZs, the following incentives apply to economic activities:

- > an exemption from CIT in the first six years and a 50% reduction (i.e. 7.5% tax rate) for the next ten years
- > exemption from land tax
- > exemption from dividend tax

These incentives are available to manufacturing companies which invest more than 1 million euros, and to service companies which invest more than 100,000 euros and employ more than 20 full-time staff.

Furthermore, the ready-to-build industrial sites of the FEZs come with an entire physical and legal infrastructure in place, and offer a wide range of support services.

All FEZs in Lithuania are open to foreign direct investments.

Currently under discussion: a new FEZ in the Lithuanian capital of Vilnius

The Mayor of Vilnius, Remigijus Šimašius, recently met with Lithuanian PM Saulius Skvernelis to discuss the possibility of establishing a Free Economic Zone (FEZ) near the Lithuanian capital Vilnius. It will be located in the current territory of Vilnius logistics centre, which occupies 460 hectares.

It seems highly likely that from 2020 the thriving city will have its own FEZ spread out over 400 hectares. The proposed project is being legally evaluated but looks almost certain to be greenlit. According to officials, the establishment of Vilnius FEZ would substantially boost Lithuania's attractiveness for investment. However, in order for the FEZ to be established, significant improvements to local infrastructure will have to be made, i.e. improving the main road from Vilnius to Minsk. Extensive state investment is expected, which in itself will offer tremendous opportunities for construction companies.

How to become a "Zone Company" in Lithuania (following the example of FEZ Kaunas)?

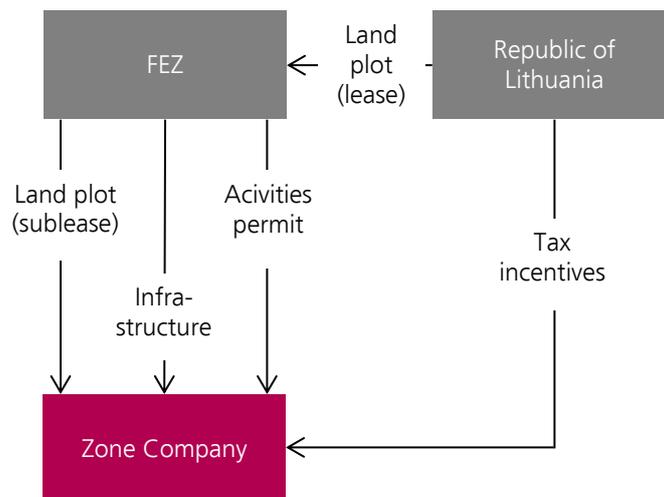
Kaunas FEZ is managed by the private firm UAB "Kauno laisvosios ekonominės zonos valdymo". It operates on the basis of a contract with the Lithuanian Ministry of Economy, which represents the Lithuanian state as the owner of the site. However, the management company has leased the land where the FEZ is based for a period of 99 years from the Lithuanian state.

Prior to setting up a business in the FEZ, the necessary permits are required from the management company. Although unofficial correspondence and negotiations between potential investors and the management company are possible before setting up in the FEZ, official applications for establishing a place in the FEZ must be filed by a project company registered in the Republic of Lithuania. Upon receipt of the initial permits, the company may conclude the sublease agreement and the agreement on activities in the FEZ with the management company.

The agreement on activities covers the principal rights and obligations of the investor, as well as their economic activity in the FEZ. The investor undertakes to achieve certain performance indicators concluded in the agreement on activities, e.g.:

- > Deadline for the application for building permits
- > Date for completion of the work
- > Number of jobs to be created
- > Investment amount over a certain period of time

Upon the conclusion of both agreements, the investor's project company needs to register its status as a "Zone Company" in the Lithuanian commercial register.



The FEZ management company retains the right to terminate the contract in the event of serious breaches, including the failure to meet performance indicators, with the result that the investor can lose its status as a Zone Company and the main tenant can terminate the sublease contract. It is recommended that investors share liability between the owner, the main tenant and the subtenant in the contract, as well as the ownership of the buildings to be erected and the resulting rights and obligations. The legal consequences of an extraordinary termination of the contract and its effects on prior investments should be covered in detail in the agreement on activities.

The conditions laid down in contracts can be negotiated between the FEZ management company and the investor in such a way that they meet the investor's specific needs. In this way, they can be more flexible and adaptable.

Advice:

- > The start-up phase of foreign investment can become cost-intensive. Tax incentives and FEZs can help to effectively cushion these costs.
- > Different kinds of investment benefit from different tax incentives and funding programs. Investors should always seek the advice of a local consultant to make the best use of local tax breaks and funding opportunities.
- > Rödl & Partner, as a major expert and consultant on investment law in Estonia, Latvia and Lithuania, will be pleased to assist you in optimizing your investment in the Baltic states.

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> News in Brief

Estonia

Estonia's ratification of the Agreement on a Unified Patent Court in force

Estonia deposited its instrument of ratification of the Agreement on a Unified Patent Court (UPCA) with the Council of the European Union on 1 August 2017. Estonia's legislation ratifying the UPCA came into force on 26 June 2017, but the deposit means that the ratification has become effective. Until today, a total of 13 countries have ratified the agreement.

Latvia

Several important changes to the Commercial Law of Latvia

On 13 July 2017, amendments to the Commercial Law came into force that introduce several new provisions concerning the reachability of companies, the number of board members in a company's articles of association and employee shares.

The amendments state that companies which are not reachable at their legal address may be liquidated. Liquidation can occur on the basis of a decision of the Commercial Registry if a company is not reachable at its legal address and has not corrected this violation within two months of receiving a written warning. Until now the only way for the Commercial Registry and the owner of a legal address to halt legal infringements by a company that is physically absent from its legal address was to submit an application to the court requesting the cessation of the operation of the company. The State Revenue Service can take similar actions regarding companies registered under fictitious legal addresses. The State Revenue Service is entitled to exclude a registered taxpayer from the VAT payers' register if no response has been received from the company after a written warning has been sent.

Amendments also include changes to the information deemed compulsory by the Commercial Law for articles of association. With the new amendments coming into force, it is no longer obligatory to indicate a number of board members regarding articles of association. At the moment, it is up to a company whether or not it wishes to fix a specific number of board members in articles of association.

Provisions regarding employee shares can be regarded as a particular novelty to Commercial Law. Employee shares confer the right to employees, the board and council members of a company, or companies belonging to the same group of companies, to obtain shares in the company. The total value of share nominal value shall not exceed 10% of the company's paid-up capital when the decision on allocating employee shares is taken.

Other amendments to the Commercial Law concern the conclusion of related party transactions, the sale of company shares and questions related to a company's share capital and its increase.

Natural and legal persons' account register

On 1 July 2017, the Account Register Law came into force, introducing a new system for identifying any natural or legal person who has opened a deposit or payment account. It applies to any person who has an account in a credit institution, credit union or payment service provider in Latvia.

The Register will contain information about account ownership, but no information about money transfers or account balance. Banks and other information providers will provide account holders' data, i.e. account numbers and the dates of opening and closing accounts. In addition, information about a natural person will include their personal data, while information about a legal person will include names and registration numbers.

The law strictly defines those persons who have the right to request the aforementioned information in fulfillment of their duties. These persons are the Office for the Prevention of the Laundering of Proceeds Derived from Criminal Activity, subjects of operational investigation, investigation authorities, the Financial and Capital Market Commission, the State Revenue Service, courts, the Prosecutor's Office, the Corruption Prevention and Combating Bureau, sworn bailiffs, sworn notaries, Orphans' Courts and the Bank of Latvia. Information for these users of the Register will be available as of 1 September, 2017. After closing an account, information will be stored for 5 years. The purpose of this law is to combat terrorism and tax evasion.

The latest amendments to the Law "On Taxes and Duties" stipulate that credit institutions and payment service providers are obliged to report their clients' account turnover once a year to the State Revenue Service. Information will be provided about natural persons whose account turnover in the preceding year exceeded 15,000 euros.

Amendments to the Employment Law

On 16 August 2017, amendments to the Employment Law came into force. The most important amendments concern the restriction of employee competition (non-compete clauses), the right of employers to curtail side-employment and reimbursement of overtime.

The amendments foresee that a non-competition agreement can apply to different kind of competing activities, including the independent competing commercial activity of employees, the employment of employees for the benefit of other employers, and the enticing of clients and employees by former employers. A due date concerning employers' unilateral withdrawal from a non-competition agreement has been specified. In cases of employment termination, the employer can unilaterally withdraw from the agreement only before termination of employment or simultaneously therewith, but in other cases of it must be done before termination of employment.

Employers are now restricted from limiting the rights of employees to side-employment in employment contracts, and the employer must evaluate each case separately. In certain cases, the employer is obliged to justify their reasons for any restrictions they imposed.

An alternative overtime reimbursement model has been introduced. Henceforth, the employer, where it is agreed in writing with employees, will be entitled to replace monetary reimbursement with a rest period that the employee can use within a month of doing overtime. Alternatively, the rest period can be added to the employee's paid annual vacation.

Lithuania

Proposal to give shareholders easier access to a company's confidential information

A new proposal to amend the Law on Companies has recently been submitted to the Lithuanian Parliament. The proposed changes would mean that shareholders, irrespective of the amount of shares they hold, would be able to access confidential information pertaining to the company in which they hold shares. At present only shareholders with at least a 50% stake in a company have the right to access such information. The proposed changes are part of Lithuania's preparations to join the OECD in 2018.

Amendments to Lithuania's Law on Public Procurements

The amended Law on Public Procurement came into force on 1 July 2017. The new law introduces numerous legal and technical changes with regard to public procurement procedures.

Following an EUCJ ruling at the end of June 2017, the Lithuanian Supreme Court delivered its decision regarding the legality of a provision in the Law on Public Procurement.

The main concern of the case was the provision which stipulates that the works procured (as indicated by the purchaser) have to be performed by the contractor and not subcontractors employed by the contractor. The Supreme Court ruled that this provision restricts the freedom to provide services and should therefore no longer be applicable. Subcontractors will now be allowed to carry out work procured in tenders.

Amendments to Lithuania's Law on the Prevention of Money Laundering and Terrorist Financing

On 29 June 2017, the Lithuanian Parliament adopted amendments to the Law on Prevention of Money Laundering and Terrorist Financing. Companies will now have to collect information on the ultimate beneficial owners of its clients that conduct transactions that exceed 10,000 euros in cash.

> Internal

Latvia

New lawyer in office of Rödl & Partner Riga



Before joining Rödl & Partner, lawyer Simona Krastiņa worked at the Constitutional Court of the Republic of Latvia for more than six years and a regional administrative court, mainly specializing in administrative law and state law.

Ms. Krastiņa studied law at the University of Latvia, where she is on her way to obtaining a doctoral degree.

Advancing together

„In close collaboration with our clients we develop value-creating ideas that we implement together.“

Rödl & Partner

„In connecting and striving for common thinking we regard unity as the clearest form of expression. It is an essential component of our ongoing repertoire.“

Castellers de Barcelona



“Each and every person counts” – to the Castellers and to us.

Human towers symbolise in a unique way the Rödl & Partner corporate culture. They personify our philosophy of solidarity, balance, courage and team spirit. They stand for the growth that is based on own resources, the growth which has made Rödl & Partner the company we are today.

„Força, Equilibri, Valor i Seny“ (strength, equilibrium, valour and common sense) is the Catalan motto of all Castellers, describing their fundamental values very accurately. It is to our liking and also reflects our mentality. Therefore Rödl & Partner embarked on a collaborative journey with the representatives of this long-standing tradition of human towers – Castellers de Barcelona – in May 2011. The association from Barcelona stands, among many other things, for this intangible cultural heritage.“

Imprint Baltic Newsletter, Issue October 2017

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