

The International Comparative Legal Guide to: Securitisation 2007

A practical insight to cross-border Securitisation Law



Published by Global Legal Group with contributions from:

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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the debtor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of historic relationships?

- (a) There are no formal contract requirements as to the sale of movable goods (unless the sale involves securities) or services. Exceptions to this rule concern relationships between a credit institution and its clients;
- (b) an invoice may be considered evidence for the conclusion of an oral contract, but in case of a dispute this will eventually be decided by the judge. Based on the general practice, it may be suggested that an invoice might be deemed sufficient if signed by both parties; and
- (c) where oral contracts are acceptable, the historic relationship of the parties may be deemed acceptable as a basis for the contract, for example if the parties have been involved in long-term commercial relations and one of them submits an offer for the conclusion of the contract, and the other party fails to timely object.

1.2 Consumer Protections. Do your country’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; or (c) provide other noteworthy rights to consumers with respect to receivables owing by them?

- (a) There are no limits or restrictions on interest rates, except for the right of the consumer to refrain from payment of the full interest amount in the case of premature repayment of the loan;
- (b) unless otherwise specified by the relevant agreement, the statutory interest on late payment is the European Central Bank interest rate, to which 7% is added; and
- (c) specific restrictions are set forth for consumer protection regarding “doorstep” and distance agreements.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the debtor do not specify a choice of law in their receivables contract, what are the main principles in your country that will determine the governing law of the contract?

The contract will be governed by the law of the state the contract is

most closely connected to. The contract is presumed to be most closely connected to the state of residence or seat of the governing body (management board, board of directors) of the party who is to perform the obligation characteristic of the contract at the time of entry into the contract.

2.2 Base Case. If the seller and the debtors are resident in your country, and the transactions giving rise to the receivables and the payment of the receivables take place in your country, and the seller and the debtor choose the law of your jurisdiction to govern the receivables contract, is there any reason why a court in your country would not give effect to their choice of law?

No there is not.

2.3 Freedom to Choose Other Law. If the seller and the debtors are resident in your country, and the transactions giving rise to the receivables and the payment of the receivables take place in your country, can the seller and the debtor choose a different country’s law to govern the receivables contract and the receivables?

The parties to the contract are generally free to choose the applicable law. The court will uphold the choice of a foreign law insofar as it does not contradict the main principles of the Estonian legal system. Nevertheless, some authorities (legal scholars etc.) believe that the choice of foreign law should only be enforceable if the transaction has some connection to the relevant foreign jurisdiction. The aforementioned position however has not been so far reflected in laws or guiding court practice.

2.4 Seller Resident. If the seller is resident in your country, and the seller and the debtor choose the law of your country to govern their receivables contract, will a court in your country give effect to their choice of law?

Yes, unless the receivable represents a registered security, in which case the law of country where the relevant registry is situated will apply to the property and related rights. The court may also refuse to uphold the choice of law, where the debtor is a consumer and the choice of law will result in depriving the debtor of the protection granted to him by the law of his state of residence.

- 2.5 Debtor Resident. If the debtor is resident in your country, and the seller and the debtor choose the law of your country to govern their receivables contract, will a court in your country give effect to their choice of law?

Yes they will.

3 Choice of Law - Receivables Purchase Agreement

- 3.1 Freedom to Choose Other Law. If your country's law governs the receivables, and the seller sells the receivables to a purchaser in another country, and the seller and the purchaser choose the law of the purchaser's country or a third country to govern their sale agreement, will a court in your country give effect to their choice of law?

Parties to the contract are entitled to choose the law of any country to govern the sale agreement insofar as it does not contradict the main principles of the Estonian law. In such case, Estonian law applies.

- 3.2 Other Advantages. Conversely, if another country's law governs the receivables, and the seller is resident in your country, are there circumstances where it would be beneficial to choose the law of your country to govern the sale agreement?

There is no specific reason to choose the Estonian law to govern the contract. It may, however, be beneficial for strategic tax or liability purposes (lower court awards, almost no discovery procedures, more flexible consumer protection laws, etc.).

- 3.3 Effectiveness. In either of the cases described in questions 3.1 or 3.2, will your country's laws apply to determine (i) whether the sale of receivables is effective as between the seller and the purchaser; (ii) whether the sale is perfected; and/or (iii) whether the sale is effective and enforceable against the debtors?

In the case described in question 3.1, Estonian law will govern the relationship between the purchaser and debtor, but not the effectiveness of the transactions between the seller and the purchaser. Estonian law may also apply as to whether the sale is perfected, where perfection is performed by means of transfer to the purchaser of collaterals securing the receivables. In such a case, the validity of the agreement governing the transfer will be regulated by Estonian legal acts. Estonian law will also apply to determine, whether the sale is effective against the debtors.

Conversely, in the case described in question 3.2 (where Estonian law is chosen to govern the sale agreement), the Estonian law will govern the effectiveness of the transaction between the seller and purchaser. The law governing the receivables will apply to determine the effectiveness of the sale against the debtor and to perfection of the sale.

4 Asset Sales

- 4.1 Sale Methods Generally. In your country what is (are) the customary method(s) for a seller to sell accounts receivables to a purchaser?

A valid and binding agreement must be entered into in order to sell

accounts receivable. Although the law generally does not prescribe the form of the contract, it is customary to execute a written contract. If some form requirements are imposed by law, or prescribed by the contract of receivables, the purchase agreement is to be concluded in the same form as the underlying contract.

- 4.2 Perfection Generally. What formalities are required generally for the sale of accounts receivable to be perfected? Are there any additional or other formalities required for the sale of accounts receivable to be perfected against any subsequent good faith purchasers for value of the same accounts receivable from the seller?

There are no specific requirements regarding perfection of the sale of accounts receivable. The major risk arising out of the sale of accounts receivable is not related to later, but to earlier purchases. There is always a risk that the receivable in question has already been sold, in which case the former conveyance shall prevail over the latter.

- 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

A promissory note can be transferred to another person by means of an endorsement in writing, unless the drawer has expressly precluded transferability. If the drawer has precluded the transferability, the note may be transferred as a registered security. A right arising from a registered security shall be transferred pursuant to the provisions concerning the transfer of the corresponding right in writing, concurrently with the transfer of the security. An endorsement of the promissory note shall be unconditional. An endorsement for partial transfer of the rights and obligations expressed in a promissory note is void.

Loan agreements are technically form-free, unless concluded by a credit institution. Since the establishment of a mortgage requires an agreement certified by the notary, the perfection of the sale of a mortgage loan together with the mortgage securing the loan involves a notarized assignment of the mortgage. Consumer loans are generally concluded in writing, particularly where the lender is a credit institution, and therefore the purchase contract is also to be executed in writing.

The transfer of marketable debt securities is regulated depending on whether the debt security is registered with the Estonian Central Registry of Securities. If registered, the securities are transferred electronically from one securities account to another by the registrar. The regulation of the sale of non-registered debt securities may vary depending on the type of security, and will usually require the transfer of possession of the security, which will perfect the sale.

There are no specific restrictions/requirements as to the perfection of the sale of consumer loans.

- 4.4 Debtor Notification. Must the seller or the purchaser notify debtors of the sale of receivables in order for the sale to be an effective sale against the debtors?

The notification to the debtor is not obligatory according to the Law of Obligations Act but highly recommendable in the interests of the purchaser. The notification prevents the debtor from performance of its obligations to the seller. The failure to notify the debtor will not, however, influence the right of the purchaser to enforce the debt directly against the debtor. The debtor may withhold the performance of his obligation to the purchaser until presented with

a valid assignment document.

- 4.5 Debtor Consent.** Must the seller or the purchaser obtain the debtors' consent to the sale of receivables in order for the sale to be an effective sale against the debtors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment?

The consent of the debtor for the sale of a receivable is only required to avoid the breach of the anti-assignability clauses in the receivable contract, but it does not influence the enforceability of the claim against the debtor by the purchaser. Where the assignment is not prohibited by the contract, it is deemed permitted.

- 4.6 Liability to Debtor.** If the seller sells receivables to the purchaser even though the receivables contract expressly prohibits assignment, will the seller be liable to the debtor for breach of contract?

Yes they will.

- 4.7 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., debtor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics?

No specific information required for the sale of the securities except for the requirement that the receivables be sufficiently identifiable. Therefore, the contract for the sale of receivables should contain all the information reasonably required to identify the receivable being transferred.

- 4.8 Economic Effects on Sale.** What economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; and (c) control of collections of receivables without jeopardising perfection?

The parties are free to agree that the seller will retain certain risks or control over the collection of the receivable, but in such case, the transaction may be re-characterised as a secured loan.

- 4.9 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables?

The law requires that the receivables to be sold should be sufficiently identifiable at the moment of their assignment. Therefore, unless the receivable to be sold continuously can be sufficiently identified at the moment of assignment, such sale cannot be perfected.

- 4.10 Future Receivables.** Can the seller commit in an enforceable manner (both prior to and after its insolvency) to sell receivables to the purchaser that come into existence after the date of the sale contract (as in a "future flow" securitisation)?

The transfer of the conditional receivables or those emerging in the

future is allowed, if such receivables are sufficiently identifiable at the time of their creation. However, such assignment will be declared invalid by the insolvency official if performed after initiation of the bankruptcy proceedings.

- 4.11 Related Security.** What additional formalities must be fulfilled for the concurrent transfer of related security to be enforceable? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Security related to the receivables is deemed to be transferred to the purchaser upon assignment of the claim. It is presumed that the seller is also obliged to transfer the security not related (which does not extinguish upon extinguishment of the claim, such as a mortgage or any other registered security) to the receivables. However, for the transfer of certain types of securities (mortgage, floating charge, financial collateral, pledge of registered security etc.) a notarised assignment document shall be executed in order to perfect the transfer of related security (see below).

5 Security Interests

- 5.1 Back-up Security.** Is it customary in your country to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No it is not customary.

- 5.2 Seller Security.** If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of your country, and for such security interest to be perfected?

This is not applicable in Estonia (see question 5.1 above).

- 5.3 Purchaser Security.** What are the formalities for the purchaser granting a security interest in receivables and related security under the laws of your country, and for such security interest to be perfected?

A security interest over accounts receivable may be granted by way of the establishment of a written pledge, and by giving notice to the debtor. The consequence of the notification is that before the secured claim has become due, the debtor is only entitled to perform its obligation to the purchaser and pledgee jointly, and after the secured claim has become due, solely to the pledgee. It is also possible to establish financial collateral by entering into a written agreement.

- 5.4 Recognition.** If the purchaser grants a security interest in the receivables under the laws of the purchaser's country or a third country, and that security interest is valid and perfected under the laws of that other country, will it be treated as valid and perfected in your country?

Yes, unless it is in contradiction with Estonian public policy.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to promissory notes, mortgage loans, consumer loans or marketable debt securities?

If an endorsement of a promissory note contains a written declaration implying a pledge (a pledge endorsement), the holder of the promissory note may exercise all rights arising from the note as the pledgee.

Pledge over registered securities is established by filing an entry in the Estonian Central Register of Securities on the order of the account administrator of the pledgor acting on instruction of the pledgor. A pledge of securities is created upon entry of the pledge in the register. The registrar makes a notation concerning pledged securities in a securities account in the register.

In the case of financial collateral, the registrar transfers the securities pledged on the basis of a financial collateral arrangement to the special securities account of the pledgor on the order of the account administrator of the pledgor. The encumbrance of non-registered debt securities depends on the type of debt security and may require transfer of possession thereof.

No specific regulation is set forth regarding mortgage loans or consumer loans, except if a credit institution is party to the underlying agreement.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will your country's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables ("automatic stay")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected?

No, there is no automatic stay in Estonia. For the answer to the second question please see question 6.2 below.

6.2 Insolvency Official's Powers. If there is no automatic stay, under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

Upon the initiation of the bankruptcy proceedings or prior to them, the court conducting the proceedings is entitled to apply certain measures restricting the exercise of the ownership rights over the property of the purchaser should the property in question be subject to recovery. Such measures may, at the discretion of the court, include entry of the notation prohibiting the disposal into the relevant registry, prohibition of the fulfilment of the obligation to the purchaser, etc.

6.3 Suspect Period. Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding?

General grounds for recovery of transactions during the insolvency proceedings are the following: the transaction was entered into a)

during the period from the commencement of the proceedings until declaration of bankruptcy; b) within one year before the bankruptcy commencement and the other party knew or should have known that the transaction is detrimental to the interests of the creditors; c) within the period from one to three years before the commencement of the proceedings, and the debtor intentionally damaged the interests of the creditors, and the other party to the transaction knew or should have known that the debtor damaged their interests; or d) within five years before the commencement of the bankruptcy if the debtor intentionally damaged the interests of the creditors by the transaction and the other party to the transaction was a person connected to the debtor and knew or should have known of the damage. There are also specific terms for reversal of specific transactions.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

There are no circumstances under which the assets and liabilities of the purchaser can be consolidated with those of the seller, except in the case of criminal activities of either the seller or the purchaser, whereby the purchaser may be considered as a "tool" for committing the crime by the seller, or vice versa.

6.5 Effect of Proceedings on Future Receivables. What is the effect of the initiation of insolvency proceedings on (a) sales of receivables that have not yet occurred or (b) on sales of receivables that have not yet come into existence?

Any future sales of receivables may be hindered because the court will usually impose the prohibition on further disposal of the debtor's assets, and any transactions entered into by the debtor during the period from the initiation until declaration of bankruptcy are subject to recovery.

Should the receivable be assigned but not have come into existence by the time of initiation of bankruptcy proceedings, the assignment becomes void upon declaration of bankruptcy with regard to claims which may arise after the declaration of bankruptcy.

7 Special Rules

7.1 Securitisation Law. Does your country have laws specifically providing for securitisation transactions? If so, what are the basics?

There are no laws specifically providing for securitisation transactions.

7.2 Securitisation Entities. Does your country have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to (a) requirements for establishment of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There are no laws specifically providing for the establishment of special purpose entities for securitisation.

- 7.3 Non-Recourse Clause.** Will a court in your country give effect to a contractual provision (even if the contract's governing law is the law of another country) limiting the recourse of parties to available funds?

There are no legal grounds for invalidity of such provision. However, agreements under which liability is precluded or restricted in cases of intentional non-performance or which allow the debtor to perform an obligation in a materially different manner, or which unreasonably exclude or restrict liability in some other manner, are void.

- 7.4 Non-Petition Clause.** Will a court in your country give effect to a contractual provision (even if the contract's governing law is the law of another country) prohibiting the parties from (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Generally, agreements under which liability is precluded or restricted for intentional acts are prohibited, and terms that are detrimental to the interests of a consumer are void. Finally, under Article 15 of the Constitution of the Republic of Estonia, any person whose rights and freedoms are violated has a right of recourse to the courts. Therefore, the validity of agreement restricting the right to file for bankruptcy or other lawsuits is questionable.

- 7.5 Independent Director.** Will a court in your country give effect to a contractual provision (even if the contract's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

The court will uphold such provision. Nevertheless, in case of Estonian entities, such prohibition will not be effective in respect of third persons unless the relevant entry is made in the commercial register. The prohibition on commencement of insolvency proceedings will not, however, have any practical implementation because the Estonian Commercial Code obliges members of the management board of the entity to initiate bankruptcy proceedings within 20 days of the appearance of permanent insolvency of the entity. The breach of this duty will result in the personal liability of the member of the management board. Therefore such prohibition would be invalid in case of Estonian entities.

8 Regulatory Issues

- 8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in your country, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any license or its being subject to regulation as a financial institution in your country? Does the answer to the preceding question change if the purchaser does business with other sellers in your country?

No it will not.

- 8.2 Data Protection.** Does your country have laws restricting the use or dissemination of data about or provided by debtors? If so, do these laws apply only to consumer debtors or also to enterprises?

There are a few restrictions on the use and dissemination of data about or provided by debtors. First, the Personal Data Protection Act prohibits the processing of personal data about, or provided by a natural person without their prior consent. Second, the Credit Institutions Act imposes upon a credit institution an obligation to maintain banking secrecy. Such data may only be transmitted to any third person with the prior written consent of the client. Similar restrictions may apply to other institutions, such as insurance companies.

- 8.3 Consumer Protection.** If the debtors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of your country? Briefly, what is required?

Generally, consumer protection acts apply with respect to the relationship between seller and consumer. Since the purchaser only overtakes the claim against the consumer on the conditions stipulated in the receivable contract and is not therefore entitled to alter the legal position of the consumer, and any clauses detrimental to the scope and essence of the right of the consumer may be null and void.

- 8.4 Currency Restrictions.** Does your country have laws restricting the exchange of your country's currency for other currencies or the making of payments in your country's currency to persons outside the country?

No it does not.

9 Taxation

- 9.1 Withholding Taxes.** Will any part of payments on receivables by the debtors to the seller or the purchaser be subject to withholding taxes in your country? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

The payments on receivables by the debtors to seller or the purchaser are not subject to withholding taxes in Estonia. However the tax will be withheld at the time of profit distribution because the system of corporate earnings taxation in Estonia shifts the moment of corporate taxation from the moment of earning the profits to the moment of their distribution. Undistributed profits are not subject to income tax, regardless of whether they are invested or merely retained.

Income tax (currently 22%) is charged and withheld on interests received by a non-resident of the Estonian State, a local government or a resident, or from a non-resident through or on account of its permanent establishment registered in Estonia. Tax is charged on the difference between the interest received and the interest payable according to market conditions on similar debt obligations.

- 9.2 Seller Tax Accounting.** Does your country require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

There is no special regulation or any specific accounting policy for

tax purposes by the seller or purchaser in the context of a securitisation.

9.3 Stamp Duty, etc. Does your country impose stamp duty or other documentary taxes on sales of receivables?

No it does not.

9.4 Value Added Taxes. Does your country impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The government of Estonia imposes value added tax (“VAT”) on sales of goods and services of the person whose taxable supply exceeds 16,000 EUR in a calendar year. If receivables are sold through economic activity, VAT is imposed. According to the Value Added Tax Act (“VATA”), a transfer of any right is also considered to be a service and there is no exemption to exclude the transfer of a claim (assignment of claim) as a service from the scope of VAT.

According to the VATA, the taxable value of a factoring service shall be the contract fee and the fee for handling the accounts. The VATA stipulates that the claim amount itself is not subject to taxation, but that only the contract fee and the fee for handling the accounts shall be taxable to the Estonian VAT of 18%. Accordingly, the amount of the receivable transferred is not taxable with VAT, but the commission or other fees charged in connection with the assignment of receivables are subject to VAT in Estonia.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims against the purchaser or on the receivables or collections for the unpaid tax?

According to the VATA, the person liable for VAT is the person who creates the taxable supply as a result of the business. Thus, if the seller does not pay the tax, the claims for unpaid tax can only be made against the seller and not the purchaser or on the receivables or collections. It is the purchaser’s duty to ascertain that the seller has been registered as a VAT-liable person if the purchaser deducts the sum from VAT calculated on its taxable supply.

9.6 Doing Business. Assuming that the purchaser conducts no other business in your country, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the debtors, make it liable to tax in your country?

If the purchaser appoints the seller as its servicer and collection agent, the seller can be considered to be a representative of a non-resident. If a representative of a non-resident operates in Estonia and is authorised to carry out and repeatedly carries out transactions in the name of the non-resident, such non-resident is deemed to have a permanent establishment in Estonia with respect to those transactions, and is required to register itself in the regional tax centre of the Tax and Customs Board prior to the commencement of activities. The profits of a permanent establishment are taxed in the same way as the income of resident legal persons. Obligations are reduced for subjects of countries with which Estonia has a double taxation treaty.

Acknowledgement

The authors gratefully acknowledge the assistance of Ms. Kadri Jõgi in the preparation of the tax section of this chapter.

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Attorneys at Law Luiga Mody Hääl Borenius is the largest and a fast growing law firm on the Estonian legal market providing legal assistance based on local law as well as focusing on international transactions. The office continues to hold its strong position in providing legal counselling in the fields of banking/finance, capital markets, M&A, competition and taxation matters. The number of lawyers practicing law in the firm is more than 33. The majority of our clients comprise investment banks, credit institutions, private equity funds, real estate funds, domestic and international retail, industrial, construction and transport (aviation, maritime, railways etc.) companies. English is the main working language of the office in addition to Estonian, but service is also provided in Russian, Finnish, and German.

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