

# The New Estonian Limited Partnership Regime

With the Investment Funds Act of 14 December 2016 (IFA), a new regime of Estonian limited partnership funds (LPF) has been enacted. LPF is an investment vehicle designed primarily for closed-end collective private equity and venture capital investments. The new regime has been designed along the lines of the best qualities of limited partnership structures of various countries, which have been traditionally considered as attractive jurisdictions for collective private equity and venture capital investments, such as UK, Luxembourg and Jersey.

## FLEXIBILITY

The IFA sets forth a limited set of mandatory rules, which each LPF must comply with. It leaves remarkable flexibility and freedom for the partners to agree in the limited partnership agreement (LPA) on the rules applicable to the LPF.

Among others, the partners have the right to regulate the following matters in the LPA:

- partnership's purpose and investment policy;
- duration of the partnership;
- partners' contributions, including capital and loan;
- allocations, sharing and distributions of profits;
- payment of carried interest;
- appointment, removal and withdrawal of general and limited partners;
- powers of the partners;
- payment of fees and expenses, including management fees, establishment costs, transaction costs, and general partner's fee income;

Estonian Limited Partnership Fund is a new, flexible and tax-transparent investment vehicle for private equity and venture capital investments.

- transfer of partners' interests;
- termination of the partnership.

## STRUCTURE AND MANAGEMENT

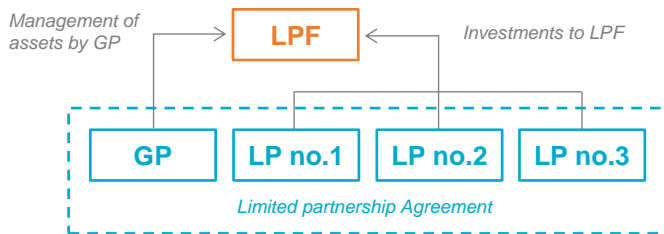
Each LPF must have at least one general partner (GP) and one limited partner (LP). Furthermore, as it is an alternative investment fund, it must invest funds raised from at least two investors (e.g. the GP and the LP or two LPs).

An LPF may operate as a self-governed partnership or a limited partnership managed by a management company.

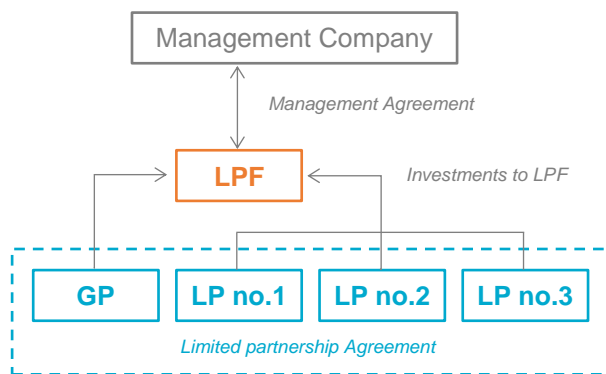
The assets of a self-governed LPF are managed by its GP. In the event a management company has been contracted, the management company has the authority to manage the assets according to the management agreement between the LPF and the management company.

LPs may engage in the management of the LPF according to the rights given to them by the LPA.

### Self-governed LPF



### LPF managed by a management company



## PARTNERS' LIABILITY

The GP has unlimited liability for the obligations of the LPF. The liability of an LP is limited to the amount of the LP's contribution to the LPF, if the LP refrains from participating in the daily management of the LPF.

To provide clarity with respect to the liability of LPs, the IFA sets forth the so-called safe harbour regime, whereby an LP is considered not to participate in the daily management of the LPF if, among other things, the LP:

- represents the Estonian LP under a specific power of attorney;
- exercises general LPs' rights arising from laws or set forth in the LPA;
- advises the GP or the management company in matters pertaining to the management of the Estonian LP, unless such advice constitutes binding instructions, which the GP or the management company must adhere to;
- guarantees or secures the obligations of the Estonian LP;
- participates in amending the LPA;

- exercises voting rights or otherwise expresses an opinion on any of the following matters:
  - continuing or terminating the activities of the Estonian LP;
  - acquisition of assets by the Estonian LP;
  - transferring or encumbering partners' interests;
  - amending the investment policy of the Estonian LP;
  - merger of the Estonian LP (including a merger of the LPF and one of its partners);
  - withdrawal or removal of a partner;
  - making a transaction between the Estonian LP and its partner.

## ESTABLISHMENT

An Estonian LPF is established by the conclusion of its LPA and its registration with the Estonian Commercial Register (äriregister). The LPF is registered with the Estonian Commercial Register on the basis of an application executed and submitted by:

- the GP or each GP if the LPF has more than one GP,
- and unless the LPF is established as a self-governed partnership, the management company.

A statement by the Estonian FSA (Finantsinspektsioon) confirming that the GP or the management company has been properly registered or authorised as an alternative investment fund manager (AIFM) must be appended to the application.

An application is normally processed and the LPF is registered within five business days.

## CONFIDENTIALITY OF LPS

An LPF does not have to publish the identity of its LPs or the amount of the investments made by each LP.

## AUTHORISATIONS

An Estonian LPF is an alternative investment fund within the meaning of Directive 2011/61/EU (AIFMD). For this reason, at least one GP or the management company must be:

- authorised to operate as an AIFM in Estonia or another Member State of the European Economic Area, or
- registered with the Estonian FSA as an AIFM.

An Estonian company can be registered with the Estonian FSA as an AIFM if it intends to operate as an AIFM but is not required to obtain an authorisation of AIFM according to the exception laid down in Article 3 of the AIFMD. To register with the Estonian FSA, the company must provide the FSA with information on the Estonian LPF and its planned activities. As an AIFM, it must submit its annual reports to the Estonian FSA.

### TAX TRANSPARENCY

The availability of a fiscally transparent fund vehicle has been widely recognised as a critical condition for creating an attractive environment for investment fund structuring. This condition has now been met in Estonia by introducing a full fiscal transparency regime applicable to LPFs.

Fiscal transparency means that an Estonian LPF is not considered a taxpayer or an Estonian resident for the purposes of Estonian tax laws, and the income earned by an LPF is immediately allocated to its investors in proportion to their stakes in the LPF.

One of the objectives of such “see-through” approach is to ensure that the foreign investors of the Estonian LPF are treated, tax-wise, in exactly the same way as when investing directly in company shares. One important consequence of fiscal transparency is that the foreign investors should normally have full access to double taxation treaties between the residence state of the investor and the source state of the respective income.

In the case of non-resident investors, the LPF’s income allocated to such investors will not be taxed in Estonia in most cases. Such income will only be taxed in Estonia in situations where the same income, should it have been earned by a non-resident directly, would be taxed in Estonia. Such situations exclusively include income from Estonian real estate (capital gain, rental and interest income). The non-resident investors will only have to declare the investment income earned through the Estonian LPF, if such income is taxable in Estonia.

An LPF itself will have to submit annual declarations to the tax authority regarding the income earned, the investors of the LPF, the share of LPF’s income allocated to each investor and the tax residence of each investor.

### KEY CONTACTS



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