

The ABCs for a sole proprietor

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Starting a business and overview of liabilities

WHAT IS BUSINESS

For the purpose of the Income Tax Act, business is a person's independent economic or professional activity (including the professional activity of a notary or bailiff and the creative activity of a creative person engaged in a liberal profession), the aim of which is to derive income from the production, sale or mediation of goods, provision of services, or other activities, including creative or scientific activity (**subsection 14 (2) of the Income Tax Act 2**).

For the purpose of the Value-Added Tax Act, business means the independent economic activity of a person in the course of which goods are transferred or services provided, whatever the purpose or results of that activity. The professional activities of a notary and bailiff are also deemed to be business (**subsection 2 (2) of the VAT Act**).

According to the regulatory legislation about their activities as regards accounting and taxation, notaries and bailiffs are deemed to be sole proprietors.

WHO IS SOLE PROPRIETOR

Sole proprietor is a natural person who is engaged in business. Any natural person can be a sole proprietor, including a minor of at least 15 years of age to whom his/her parent has granted consent or a court has extended his/her active legal capacity to engage in economic activity (**sections 9 to 11 of the general part of the Civil Code Act**).

A sole proprietor and their business as an economic entity through which they operate **is not a legal person**.

A sole proprietor may operate in areas of activity in which operation is not prohibited by law. The laws may provide for areas of activity for which a licence is required or in which only a particular class of undertaking may operate (**subsections 4 (1) and (2) of the Commercial Code**).

Organisation of business includes the following characteristic features:

- ✓ sole proprietors themselves decide how, to whom, where and when they provide their services;
- ✓ sole proprietors provide goods or services in their own name (independently) to other persons (purchasers/contracting entities);
- ✓ sole proprietors may employ other persons, that is, they may be employers to other persons;
- ✓ sole proprietors acquire and repair the devices, work equipment and the like used in their business,

- ✓ on own account;
- ✓ sole proprietors organise their accounting pursuant to the Accounting Act;
- ✓ sole proprietors determine the proportion of the part of their assets used in their business and the proportion of use of these assets in business;
- ✓ sole proprietors acquire materials, goods and services for their business on own account;
- ✓ sole proprietors cannot be their own employer, send themselves to a business trip, pay themselves a salary or a compensation for the employment related use of a personal automobile or grant themselves fringe benefits;
- ✓ sole proprietors may not conclude transactions with themselves (for example, enter into a loan agreement, an asset sale contract with themselves)
- ✓ sole proprietor as an undertaking bears the risk related to economic activities, assuming responsibility for their activity with all of their assets, that is, with both of the assets used in business and their personal property;
- ✓ sole proprietors submit to the Estonian Tax and Customs Board Form E of the income tax return reflecting the income and expenditure derived from their business as a sole proprietor.

Registration of natural person as sole proprietor

Before starting business activities, all sole proprietors must apply for their entry in the **commercial register**. Sole proprietors are entered in the commercial register based on the application submitted by the person concerned (**§ 3 of the Commercial Code**).

To register a sole proprietor with the commercial register, an application for entry in the register must be submitted (digitally signed or certified by a notary) to the commercial register. The application must contain the following information:

- ✓ business name (requirements for a business name in **sections 7 to 15 of the Commercial Code**), in case a name of farm is used, the reference to the number of the registered immovable property in the land register should be added;

- ✓ postal address of sole proprietor (number of apartment and house; name of street or farm, name of settlement, local government, county and postal code);
- ✓ details of sole proprietor (first name and surname, Estonian personal identification code or the birth date);
- ✓ beginning and end of the financial year (please note that irrespective of the sole proprietor's financial year, a period of taxation is still a calendar year);
- ✓ if needed, information on the suspension of business activities, seasonal or temporary activity (**§ 3 (3) of the Commercial Code**);
- ✓ means of communication (phone, fax, e-mail, website etc.);
- ✓ information on the planned principal activity. Unlike other sole proprietors, farmers may have two activities registered in the commercial register (for example, in a tourism farm the farmer may be engaged in production of agricultural products and accommodation services at the same time).
- ✓ receipt of the payment of state fee.

More information can be found on the website of the Ministry of Justice on the page "**Sole proprietor**" (in Estonian).

Notaries are registered by the Estonian Chamber of Notaries whereas bailiffs are registered by the Estonian Chamber of Bailiffs and Trustees in Bankruptcy.

The tax authority uses the information on sole proprietors obtained from the commercial register, the Estonian Chamber of Notaries and the Estonian Chamber of Bailiffs and Trustees in Bankruptcy. Therefore, it is important that the information on sole proprietors entered in the register be correct. Hereby it should be borne in mind that sole proprietors must perform their tax liabilities as long as they are entered in the register as a sole proprietor.

SOLE PROPRIETOR AS A SALARIED WORKER

Being a sole proprietor does not exclude working under an employer. Whereas a sole proprietor and a natural person is the same person, the natural person may earn income in various ways (for example, income from employment, income from transfer of securities, business income, etc.), but they must differentiate their different kinds of income on the income tax return of natural person.

REGISTRATION OF A SOLE PROPRIETOR IS PUBLIC INFORMATION

All interested persons may check out [via the Information System of the e-Commercial Register](#) whether the person has been registered as a sole proprietor.

FOR YOUR INFORMATION

- ✓ The obligations arising from the tax legislation shall also extend to sole proprietors who have not registered themselves with the commercial register;
- ✓ the rights provided for in the tax legislation apply to sole proprietors as from the date of their registration in the commercial register. Thus, only the persons registered in the commercial register as a sole proprietor may make deductions from their business income as specified in [Chapter 6 of the Income Tax Act](#) .
- ✓ Transfer of securities owned by a natural person does not constitute business. Purchase-sale of securities and gains therefrom shall always be taxed as gains from transfer of property.
- ✓ Taxpayers may, at their own discretion, include also rent and royalties in their business income.

Obligations of sole proprietors

SOLE PROPRIETORS ARE OBLIGED TO:

- ✓ keep accounts on their activities;
- ✓ in addition to keeping accounts, sole proprietors must keep records of facts relevant for taxation purposes (accounting for taxation purposes);
- ✓ pay **income tax** and **social tax** on their business income and if they have joined the mandatory funded pension (II pension pillar), pay also **contribution to the mandatory funded pension**;
- ✓ in addition to Form A of the **income tax return of natural person**, submit a business income return (Form E) not later than by 30 April of the year following the period of taxation (calendar year). (*The Estonian Tax and Customs Board will calculate the social tax and contribution to the mandatory funded pension to be paid from the business income on the basis of Form E and the income tax on*

- ✓ *the basis of Forms A and E of the income tax return and send a corresponding tax notice not later than by 1 September; the taxes due by the tax notice must be paid by the sole proprietor not later than by 1 October);*
- ✓ make **advance payments of social tax** during the period of taxation;
- ✓ make **advance payments of income tax** during the period of taxation beginning from the second business year;
- ✓ sole proprietors whose business is registered in the commercial register as temporary or seasonal and who have indicated the starting date and final date of the business in their registration application are not required to inform of the start or termination of business activities for each case. Sole proprietors have the right to notify the commercial register of the suspension of the activities in advance specifying the period of time when the business is suspended. During the period of suspension, the person concerned is not a sole proprietor for taxation purposes.

PAY ATTENTION

If a sole proprietor fails to pay taxes by the due date prescribed by law (including advanced payments), the person is required to calculate and pay interest on the amount of tax outstanding at the rate of 0.06% per day by the due date. Interest is calculated as of the day following the day on which payment of the tax was due pursuant to law until the date of payment or set-off, inclusive of the latter (**subsections 115** and 117 of the Taxation Act).

In connection with the application of the state aid measures, an interest rate of 0.03% per day is charged on the amount of tax due between **16 May 2020 and 31 December 2021**.

Obligations of sole proprietor as an employer

SOLE PROPRIETOR AS AN EMPLOYER IS OBLIGED TO:

- ✓ register the employees in the employment register – this obligation arises to sole proprietors if they employ people under the employment contract or the law of obligations act (contract for services, authorisation agreement or any other contract concluded for the provision of services) and have to pay taxes on the employees' earnings;
- ✓ enter in the employment register also persons working for them voluntarily without remuneration

- ✓ (see more information in section "**Employment register**");
- ✓ withhold income tax, unemployment insurance premium and contribution to the mandatory funded pension (if the employee has joined the second pension pillar) from the payments made to the employees;
- ✓ calculate and pay social tax;
- ✓ pay unemployment insurance premiums on the payments made to the employees;
- ✓ submit a **tax return for income tax, social tax, contribution to the mandatory funded pension and unemployment insurance premium (Form TSD)** together with the corresponding annexes to the Estonian Tax and Customs Board not later than by the 10th date of the month following the month when the payments were made, and transfer the above-mentioned taxes and payments into the bank account of the Estonian Tax and Customs Board not later than by the same deadline.

Registration as a person liable to value added tax

If the taxable supply of a sole proprietor has exceeded 40 000 euros as of the beginning of a calendar year, they are obliged to register themselves **as a person liable to value added tax**. Sole proprietors can register as a person liable to value added tax also before their supply reaches 40 000 euros.

If sole proprietors fail to register for VAT purposes on time, they will be registered retroactively. In such a case, sole proprietors will have to issue new invoices that include VAT to clients to whom they issued invoices after their supply had exceeded 40 000 euros.

SOLE PROPRIETORS WHO ARE LIABLE TO VAT ARE OBLIGED TO:

- ✓ submit to the Tax and Customs Board **a value added tax return (Form KMD)** by the 20th day of the month following a period of taxation (calendar month);
- ✓ transfer the value added tax into the bank account of the Tax and Customs Board by the same date;
- ✓ submit to the Tax and Customs Board also **a report on intra-Community supply (Form VD)** by the 20th day of the month following a period of taxation (calendar month), if the person liable to value added tax, i.e. the sole proprietor, sells goods to the other persons liable to value added tax of the Member States of the European Union.

For more information, please see „**Sole proprietor and value added tax**“.