Effectiveness of the e-Residency programme

Do the revenues of the e-Residency programme exceed the expenses, and are the participants in the programme law-abiding?

Summary of the audit results

What did we audit?

In the audit, the National Audit Office assessed whether

- the e-Residency programme encourages the e-Resident companies to bring income to Estonia;
- control systems ensure that the participants in the e-Residency programme are law-abiding;
- sufficient platforms for business and services have been created for e-Residents, and
- whether the major risks involved in the implementation of the e-Residency programme have been mitigated.

Why is this important to taxpayers?

During the first five years of the e-Residency programme (2014–2019), Estonia has granted e-Residency digital ID cards to more than 63,000 foreigners from 174 countries. Digital ID allows e-Residents to use the public e-services of both Estonia and other EU countries and create an Estonian company. It is important that the e-Residents using the e-services and pursuing commercial activities be law-abiding and that they bring income to Estonia. It is also essential that the risks involved in the implementation of the programme are mitigated.

In the first five years, 15.7 million euros have been spent on the e-Residency programme.

What did we find and conclude from the results of the audit?

According to the National Audit Office, the revenues of the e-Residency programme have started to exceed the expenses by the end of the first five years of operation. However, control systems are deficient because foreigners with a valid criminal penalty and business ban can participate in the programme.

- **The revenues of the e-Residency programme exceed the expenses by almost 10 million euros**, but 95% of the revenue is paid by 6% of the companies. Thus, the income of the programme depends on a small number of companies. E-Residency programme has introduced new entrepreneurs to the Estonian business landscape, and the taxes paid by their companies have helped to bring the programme into profit. However, neither Enterprise Estonia, the governing body of the programme, nor any state agency, have a consistent and uniform overview of the total revenue and expenses of the programme, which makes it difficult to manage.

- **The ex-ante and ex-post controls do not ensure that the participants in the e-Residency programme are law abiding.** The Police and Border Guard Board (PBGB) has issued digital IDs to foreigners with valid criminal offences abroad. They have also not revoked the documents of some e-Residents who have committed a crime in Estonia during the validity of the digital ID. According to the PBGB, one of the reasons for this is that there are no IT solutions which would allow making mass inquiries to the Criminal Records Database and identifying the foreigners convicted in Estonia. In administrative proceedings, the PBGB is unable to identify persons convicted in a foreign country if the information has not been entered in international databases.

- **The ex-ante and ex-post controls do not protect Estonian entrepreneurs against e-Residents with a business ban.** The PBGB has issued digital IDs to foreigners with a valid business ban abroad and they have not revoked digital IDs for e-Residents who have received a business ban abroad during the validity of the document. As a result, the e-Residents with business bans are board members in Estonian companies. Estonia recognizes Finland's business bans. According to the PBGB, they cannot make necessary inquiries into Finnish business bans during the follow-up inspection due to a lack of IT solutions. With other countries there is no existing exchange of data on business bans. As explained by the Tax and Customs Board, they have no means and options for assessing a person's tax behaviour, including the presence of business ban, which is why inquiries are made to Estonian databases only. At the same time, most of the e-Residents have never been to Estonia or engaged in business here. Because of that, the use of Estonian databases only is not sufficient to assess the law-abidingness of the applicants and e-Residents regarding taxes and business.

- **The digital ID is issued without an obligation for foreigners to contribute to the development of the Estonian economy, education, science, or culture, even though it is the legal purpose of issuing the document.** Also, the renewal of the digital ID does not depend on whether the foreigner has contributed to Estonia or not. Implementation of the obligation to contribute to Estonia would allow to ensure that the activity of the e-Residents is in line with the purpose for which the digital ID is issued. In other words, it would allow to assess, in the issue of the digital ID and during follow-up control and renewal, whether the e-Resident's activity contributes to the development of Estonian economy, science, education or culture.

- **The amendment to the law due to the e-Residency programme has increased the risk of reputational damage to Estonia.** Due to the e-Residency programme an amendment was made to the Commercial Code, allowing the company's management board to be located abroad. Together with the incomplete requirements for applying for licenses of virtual currency service providers, a situation has occurred in which a number of Estonian companies were established operating abroad and licensed by Estonia in a field that the Financial Intelligence Unit has assessed to be at high risk for money laundering and terrorist financing. The PBGB was unable to supervise the companies due to their location abroad. Even though the management board of a virtual currency service provider is no longer allowed to be located abroad, this option was available for two years. If Estonian-licensed virtual currency service providers committed fraud and it becomes public, it could damage Estonia's reputation.

- **Services are as a rule available to e-Residents, except for banking services.** According to e-Residents, they do not have major issues in finding public e-services or private sector services, and most of the e-Residents (90%) are happy with the services. However, the e-Residents claim insufficient access to banking services to be an important bottleneck. For example, banks are closing the accounts of e-Residents and it is difficult for new e-Residents to open a bank account in Estonia. The main reason why banks refuse to open accounts is that there is no certainty that the e-Residents and their companies will be operating in Estonia. If the business is done in another country, this does not allow banks to supervise the activities of the e-Residents to the required extent and ensure that the bank account is only used for lawful activities. If a company's activity had a relevant connection to Estonia, it would reduce the risks for banks.

- **Few e-Residents who have had the option, have renewed their digital IDs.** The digital ID has been renewed by every tenth e-Resident (nearly 1,900 e-Residents) whose digital ID card has expired. The results of the survey held among e-Residents showed that the e-Residents justified the non-renewal with the fact that the e-Residency programme did not meet their expectations. Problems with opening a bank account were mentioned the most.

What did we recommend as a result of the audit?

The main recommendations by the National Audit Office:

- consider the use of reverse burden of proof for e-Residency applicants and e-Residents more often. Therefore, it would be possible to request evidence of valid criminal records and absence of business bans during the application or, where appropriate, during follow-up inspection;

- establish a condition for the issue of an e-Resident's digital ID, which obliges the applicant to contribute to Estonia as well as verifying it upon extension of the ID or if required in follow up inspection;

- provide IT solutions for the PBGB for more efficient control procedures for the e-Residents to allow making mass inquiries to the necessary registers (e.g. the Criminal Records Database);

- keep as accurate an overview as possible of the total expenses and revenues of the e-Residency programme so that Enterprise Estonia and the Ministry of Economic Affairs and Communications can make informed decisions in managing the programme;

- explain the conditions for starting a company and opening a bank account in Estonia when marketing the e-Residency programme and at the beginning of the digital ID application process (e.g. in the questionnaire for the digital ID).

Responses of the Auditees: the Minister of the Interior and the Minister of Justice agreed to the need to provide the PBGB with the required IT solutions that would allow making mass queries to the necessary registers. The Director General of the PBGB noted that the making of mass queries is also aggravated by the restrictions arising from administrative proceedings. Also, as stated by the Director General, it is particularly difficult to obtain information on third-country nationals. One of the solutions as seen by the Director General of the PBGB is a political decision according to which, e-Residency would only be offered in countries doing judicial and security cooperation with Estonia.

The Minister of the Interior explained that he does not find it necessary to establish a condition for e-Residency applicants to contribute to Estonia and verify the contribution at the renewal of the digital ID.

The Director General of the PBGB agreed that the requirement to provide evidence on the absence of any punishments and business ban contributes to the management of risks but added that it is difficult to verify the correctness of such evidence.

The Minister of Foreign Trade and Information Technology agreed that in the interests of better management decisions, it is important to keep consistent and uniform overview of the revenues and expenses of the e-Residency programme. The Minister also agreed that it is important to adequately explain the conditions for opening a bank account in Estonia to those applying for e-Residency and take these into account in marketing the programme.