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# INTERNATIONAL LAWYERS NETWORK



ESTABLISHING A BUSINESS ENTITY: AN  
INTERNATIONAL GUIDE



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**HALL & WILCOX**

**ESTABLISHING A BUSINESS ENTITY IN AUSTRALIA**

**ILN CORPORATE GROUP**





## ESTABLISHING A BUSINESS ENTITY IN AUSTRALIA

### 1. Types of business entities

#### 1.1 Types of entities available through which to conduct business

The following entities are recognized as business structures to conduct business under Australian law:

##### **Sole trader**

A sole trader is the simplest form available as a business structure where an individual trades under their own name or under a registered business name. It is easy to set up as there are few legal and tax formalities required. The business name is easily registered for a minimal fee. A sole trader does not need a separate Tax File Number (TFN) or business bank account, unlike a public or private company. An individual operating as a sole trader has full control over all assets and business decisions, and can hire employees as required. Business losses can be written off to other personal income. However, a sole trader is personally responsible for the entire business including any debts incurred. Because of this unlimited liability the sole trader's personal assets can be seized to recover a debt. Hence, this structure is only suitable for micro to very small businesses.

##### **Partnership**

A partnership has some similarities with the sole trader structure, but involves multiple individuals (or companies) who share control of the business. The structure is very flexible, without any obligation to publicly disclose reports or accounts. However, similarly to a sole trader, a partnership is not a separate legal entity, and the partners are personally liable for the debts of the business. This structure is often chosen by professional services organisations and sometimes by

family owned enterprises. A formal partnership agreement or deed is commonly in place to govern the relationship. Partnerships are rarely used for trading companies.

##### **Company**

A company is a separate legal entity that has the same rights as a natural person, its own bank account, holds assets, and incurs its own debt. The liability of the owners (shareholders) of the company is generally limited to their capital contribution. Directors of the company must comply with all obligations under the *Corporations Act 2001* (Cth). There are several types of companies under Australian law:

- **Proprietary private company limited by shares (Pty Limited)**

A proprietary private company is limited to 50 non-employee shareholders. There must be at least one director who has their ordinary residence in Australia. There is no legal requirement for a secretary.

Typically, not all constituent documents must be lodged with the Australian Securities and Investment Commission (ASIC).

- **Public company**

A public company does not have an upper limit on the number of shareholders. Capital can be raised from the public by offering shares and other securities. However, there are more reporting and disclosure requirements than with a proprietary company. There must also be at least three directors of which at least two



must ordinarily reside in Australia, as well as one secretary. The level of reporting requirements depends on the whether the company is either not a disclosing entity or a company limited by guarantee.

### **Discretionary or unit trust**

A trust is a form of businesses structure frequently used in Australia. A trust is an arrangement where a trustee holds an investment, or the legal title to property, on behalf of named beneficiaries. Trusts are distinct in that they are not separate legal entities and therefore cannot enter into agreements, and must nominate trustees that act for them. A trustee is usually a private person or a corporate trustee whose sole purpose is to act as trustee for the trust. The trustee has duties to the beneficiaries, dictated by the trust deed, legislation, and the general law.

There are two main forms of trusts: unit trusts and discretionary trusts. The latter is typically used for family tax and planning purposes. Under this form, the trustee has a choice in regard of the distribution of the income and capital of the trust to any of the beneficiaries named in the trust deed. Under the unit trusts, generally used as a vehicle for public investment schemes, the trustee issues units, each of which grants upon the unit holder a proportionate interest in the overall assets and undertaking of the trusts.

### **Incorporated or unincorporated joint venture**

A joint venture is like a partnership in that it is formed by a group of individuals or companies seeking to combine their resources to conduct an enterprise. However, unlike a partnership, the liabilities and debts incurred typically stay with the parties

separately. The relationship between the parties is governed by a detailed joint venture agreement. Careful structuring of this agreement is necessary to ensure that the joint venture is not treated as a partnership for tax purposes. A joint venture usually has a definitive end and does not provide for an ongoing relationship between the parties. A joint venture may be incorporated or unincorporated.

### **Managed investment schemes**

A managed investment scheme, also known as a managed fund or collective investment, is a structure which allows groups of individuals to pool capital for a common enterprise. The scheme is managed and operated by a 'responsible entity' which is subject to Australian financial services licensing requirements. Investors do not have day to day control over the actions of the scheme.

### **Australian branch**

Foreign companies established in non-Australian jurisdictions wishing to directly carry on business in Australia may establish a branch office, usually as an alternative to incorporating a proprietary limited company. A branch office is set up by registering the foreign company with ASIC, and is not a separate legal entity. The foreign entity is therefore subject to Australian reporting and disclosure requirements

### **1.2 Matters to be considered when choosing a particular business entity type**

For many foreign companies, a key decision is whether the business will be run through the relevant offshore entity or whether to set-up an Australian entity. In making this decision, one should consider the implications of taxation, employment law, contractual and operational requirements. There is no definite rule as to which entity to use, as



there are various modes of market entry and structures that can minimise risk and maximise value. The solution very much depends on the specific circumstances and objectives.

### **Operating through a non-Australian company**

If a decision has been made to expand an overseas business into Australia without creating a local entity and by using a foreign company as a vehicle, the foreign company must be registered with ASIC. This process can take between four to eight weeks. The foreign company must appoint a local agent for the service of notices and maintain a registered office in Australia.

As the operating entity in Australia, the foreign company will be subject to Australian legislation and taxation laws and other related compliance standards. The foreign company is subject to the Australian legal framework.

Operating an Australian business through a non- Australian company often involves complex considerations and it is strongly recommended that appropriate advice is attained.

### **Setting up an Australian entity**

Foreign companies often choose to set up a local subsidiary to conduct business in Australia. The most frequently used entity is a proprietary private company limited by shares (Pty Limited).

## **2. Steps and Timing to Establish a Pty Limited company**

As the Pty Limited company is by far the most common vehicle used by foreign companies expanding into Australia we limited our explanation for market entry to this structure.

Incorporating an Australian Pty Limited company can be done relatively quickly and without great expenditure, involving minimal government fees and corresponding professional fees. With all relevant data ready, a new Pty Limited company can be incorporated within a few days.

### **Company name and Australian Company Number (ACN)**

Before deciding on the name for a new company, it should be confirmed that the proposed company name does not infringe any intellectual property rights of third parties. A company name can be reserved before incorporation takes place.

Following incorporation, each company will be allocated with a unique nine-digit Australian Company Number (ACN). Directors should ensure that the company's name and ACN appears on all relevant public documents.

### **Low minimum share capital requirement**

In Australia, there is no minimum share capital requirement for Pty Limited companies. It is acceptable and not unusual to incorporate a Pty Limited company with a share capital of A\$100.

### **Company directors**

The company must appoint at least one director who ordinarily resides in Australia. Directors of Australian companies must be natural persons and at least 18 years old. If there is at least once director with ordinary residence in Australia, the company may appoint one or several foreign directors.

### **Company secretaries**

The company may appoint a secretary. If a Pty Limited company does not appoint a secretary, each director of the company is liable for a breach of the responsibilities of a secretary. If



appointed, at least one secretary must have their ordinary residence in Australia.

### Public officer

Each company must also appoint a public officer who is responsible for complying with tax obligations and dealing with Australian tax authorities. It is common for an individual to act as both public officer and secretary.

- **Further registrations**

Further steps are required for the company to become fully operational. This includes tax registrations and if the company is to employ staff, the set-up of a pay-roll, as well as workers compensation registration and superannuation set up.

## 3. Governance, Regulation and Ongoing Maintenance

### 3.1 Regulation and ongoing maintenance, reporting requirements

Australia has numerous corporate governance regulations and guidelines, generally provided for in the *Corporations Act 2001* (Cth) and its supplementary rules.

#### Tax registration and reporting obligations

Every company must obtain a TFN from the ATO and ensure the company complies with the reporting obligations to various regulatory bodies, including the ATO, ASIC and various other agencies. This includes preparing and lodging financial reports with ASIC. In some circumstances relief from financial reporting may apply.

A company must report changes to its company details to ASIC.

As an operating business, a company will also have to apply for an Australian Business Number (ABN). It is generally necessary to

hold an ABN to register for the Australian Goods and Services Tax (GST).

Australian taxation is based on a self-assessment model, where taxpayers are responsible for lodging their own tax returns. Individuals and companies are required to lodge an annual income tax return, while companies and other entities may have further requirements for the purposes of GST and Pay As You Go (PAYG). PAYG is a system of paying instalments during the income year towards a company's expected tax liability. Under the withholding tax rules, the payer must withhold an amount from payments made and then pay that amount to the ATO, usually in regular instalments throughout the year, depending on the size of the entity.

When operating a business in an overseas location, as well as in Australia, taxation should be considered including GST implications on the relevant transactions, payment of withholding tax, the application of relevant double taxation agreements and transfer pricing rules.

The income tax rate is 30% for all companies except small businesses. The tax rate for small businesses has been cut to 27.5% from the 2016-17 financial year. This reduced rate is applicable to small businesses with a turnover of under A\$10 million and which are companies, corporate unit trusts or public trading trusts.

CGT is imposed on gains realized from the sale of assets with special rules applicable to the valuation of capital gains. For taxation purposes, the assets subject to CGT are very broad and include both tangible and intangible assets. If you are an Australian resident for tax purposes, CGT will apply to assets located anywhere in the world (not only those located in Australia).



Dividends paid by companies to their shareholders are included in the shareholders' assessable income and are subject to a dividend imputation system. The purpose of this system is to pass on a credit to shareholders for the tax that the company has paid on the profits from which dividends are paid. This system therefore ensures that dividends are ultimately taxed at each shareholder's applicable income tax rate and are not subject to double taxation. Access to credits, however, only applies to Australian resident shareholders.

A tax consolidation regime also applies for 100% owned group companies, allowing them to consolidate as a single entity for income tax purposes and ignore transactions within the group for the purposes of income tax.

Please note that the income tax year in Australia is from 1 July to 30 June and not the calendar year.

- GST

GST is a consumption tax (like the Value Added Tax or 'VAT' in other countries) imposed on the sale of most real property, goods and services. The GST may apply to supplies located in Australia as well as those supplies which may be outside Australia.

It is levied at 10%. Some supplies such as certain types of food, exports, education, and health are excluded from GST. All consumers are required to pay GST when making a purchase.

Businesses or individuals carrying on an enterprise that have an annual turnover of more than a specified amount are required to register for GST purposes. GST is reported through a Business Activity Statement (BAS) and is lodged on either a monthly, quarterly, or annual basis.

There is a simplified GST registration regime that may be available for non-resident entities.

These businesses may either be liable to the ATO or entitled to a refund each period depending on the balance of the amount of GST collected through sales compared to any tax credits received from GST paid on goods and services purchased during carrying on their enterprise.

Certain special reverse charge rules apply in certain circumstances with entities located overseas that are making supplies to Australian businesses.

- Fringe Benefits Tax (FBT)

FBT is imposed on the value of non-cash benefits provided by employers to employees.

Generally, benefits must be connected to the employee's employment to be taxable, although certain fringe benefits are either specifically subject to FBT or expressly excluded under Australian law.

The FBT year runs from 1 April to 31 March. FBT is levied on the provider of the benefit at a flat rate of 47% for the year ending 31 March 2018 and may be deductible against the employer's taxable income.

- Medicare Levy and Medicare Levy Surcharge

Medicare is Australia's public health insurance scheme. It operates by receiving contributions through the Medicare Levy and the Medicare Levy Surcharge, which are taxes imposed on Australian residents' taxable incomes.

The Medicare Levy is imposed at a flat rate of 2% of an individual's taxable income, although exemptions may be given to low income earners and foreign residents.





The Medicare Levy Surcharge is an additional flat rate of between 1-1.5% imposed on high income earners who do not have private hospital insurance.

- Superannuation tax – the Superannuation Guarantee Charge

In Australia, an employer must pay a minimum level of superannuation (known as the superannuation guarantee) to its employees to ensure that workers have money set aside for their retirement.

The current superannuation guarantee rate is 9.5% of everyone's employment earnings. With recent amendments coming into effect, the minimum rate will increase progressively over the next years until it reaches 12% from 1 July 2025 onwards.

If an employer fails to provide the minimum level of superannuation, they become liable to pay the Superannuation Guarantee Charge (SGC) which includes the amount of the shortfall in superannuation payments plus interest and administrative charges. However, in practice, most companies will contribute the minimum level of superannuation to avoid the SGC.

There are statutory limits to how much employers or employees may contribute to superannuation funds. If contributions are made in excess of these limits, a penalty charge may apply.

- Luxury car tax

The luxury car tax rate is 33% and imposed on vendors and importers of luxury cars in Australia. There are guidelines classifying a luxury car and the circumstances in which the luxury car tax arises. The tax generally applies to cars valued over approximately either A\$65,000 or A\$75,000, depending on the fuel consumption of the vehicle.

### **Other considerations when trading between Australia and other countries**

- Transfer pricing

Australian transfer pricing rules must be considered where goods or services are bought or sold between Australia and other countries.

The transfer pricing rules have particular relevance to transactions between related parties in a corporate group for the supply of goods, services or finance that are not priced on terms which would be comparable to those that would be charged between parties transacting at arm's length.

If an international transaction does not occur at arm's length or is not supported by an acceptable pricing methodology, then market prices may be substituted into the transaction for taxation purposes to ensure an appropriate level of tax is paid.

For an intra-group cross-border transaction to be deemed to have occurred at arm's length, the ATO requires that companies appropriately document the transaction as well as the pricing methodologies used for the purposes of the transaction.

Other factors that may be considered by the ATO include, amongst other things, the commercial justifications for the transaction, any applicable review processes and whether any alternatives were considered.

- Customs duty

Customs duty is imposed on goods imported into Australia. The rate of customs duty is generally around 5% of the customs value of goods, although this subject to change depending on the type of good imported.

The customs value of a good is determined as a question of law, considering the type of



good, its country of origin and the purpose of its import into Australia.

Customs duty is payable on the entry of the goods into Australia. The applicable duty rules will depend on how the classification of the goods by the relevant Australian authority, and may be altered by tariff concession orders or free trade agreements.

Australian customs duty rules are complex and importers should seek advice on a case by case basis.

- Excise duty

Excise duty is imposed on alcohol, tobacco, fuel, and petroleum products that are produced or manufactured in Australia.

If these products are imported into Australia rather than produced or manufactured in Australia, customs duty applies to their importation at a rate comparable to the excise rate (see above).

Excise duty is paid by either the manufacturer or distributor at a flat rate. The applicable excise rates may increase twice a year to reflect inflationary changes.

In addition, a licence is generally required to undertake activities in relation to excisable goods.

### **Obligations under the Competition and Consumer Act**

Companies must ensure compliance with *the Competition and Consumer Act 2010* (Cth) (CCA) or be subject to penalties.

The main provisions relevant to all companies operating in Australia are summarized below.

- Anti-competitive agreements - Contracts, arrangements or understandings which have the purpose or likely effect of substantially lessening competition are

prohibited in Australia, unenforceable and may result in substantial penalties.

Further specific prohibitions include:

- Price fixing – where parties in competition with each other enter into a contract, arrangement or understanding, which has the purpose or effect of fixing a price for the provision of goods or services.
- Exclusive dealing where a company (Supplier) supplies goods or services on the condition that the company that receives those goods or services (Receiver) will not acquire goods or services from a competitor of the Supplier, or that the Receiver must also acquire certain other goods or services directly or indirectly from the Supplier, and this arrangement has the purpose or likely effect of lessening competition in a market.
- Third line forcing is a more specific form of exclusive dealing. An offence occurs when a Supplier supplies goods or services on the condition that the Receiver will acquire different goods or services from a third party. In Australia third line forcing is an automatic breach of the CCA, and is punishable regardless of its effect on competition in a market.
- Resale price maintenance occurs when a company dictates to its resellers the minimum prices for the resale of its goods or services. Although a retail price can be recommended, companies will be in breach if they threaten not to supply goods, if those goods are not sold at the retail price requested or, otherwise, exert pressure on retailers to sell at a specified price.



- Consumer protection

By law, companies are prohibited from engaging in misleading or deceptive conduct during trade or commerce.

This prohibition has a broad interpretation and includes activities such as advertising, oral representations, as well as representations in respect to contractual matters. The consumer protection provisions of the CCA should always be considered when offering goods or services in Australia.

- Product liability

Companies that manufacture goods in Australia or import goods into Australia will be liable for defects to those goods. Defects include design, manufacturing, and instructional defects, which may or may not have an impact on safety. Whether a defect will be compensable depends on the circumstances and, whether loss or damage has been suffered.

- Unconscionable dealing

Companies must not act unconscionably in business transactions. Broadly speaking, conduct is unconscionable if the conduct is clearly unfair or unreasonable, or if the company knew, and took advantage of, the special disability of a contracting party.

### 3.2 Requirements for local directors

The legal obligations summarized below represent a non-exhaustive list of legal requirements which directors of an Australian company must comply with. As directors can become personally liable for decisions made in their capacity as a director of a company, it is critical that directors understand and adhere to all obligations imposed on them.

#### Appointment as a director

In Australia, every person from the age of 18 years or older who has not previously been disqualified from becoming a director of an Australian company may be appointed as a director of a company. Unlike other jurisdictions, directors need not reside in Australia or be Australian citizens; however, at least one company director must have their ordinary residence in Australia.

To be appointed as a director, the director must sign a notice consenting in writing to be appointed and act as a director of the company. The director must also provide the company with certain personal information about themselves.

If no special circumstances apply, a director may resign from their directorship at any time by giving written notice to the company.

#### Fiduciary duties owed to a company

On appointment, the director owes various fiduciary duties to their company which, if breached, may lead to personal liability of the director including civil and criminal penalties and liability for damages.

#### Duty to act honestly

The director must act in good faith, in the best interests of the company and for a proper purpose. This broad duty demands more than general honesty. A director must exercise independent judgment considering relevant facts, materials and other views when assessing the best interests of the company.

A breach of this duty that involves fraud, dishonesty and even recklessness may attract criminal penalties.

**Duty not to improperly use inside information or position**

A director must not make improper use of their position or information acquired during that position, to gain an advantage for himself or any other person or to cause detriment to the company. In considering whether there has been improper use of their position, it is of no consequence whether the director intended the impropriety to have a certain outcome.

A breach is likely to occur where a director uses information acquired during their position for their own benefit rather than for the benefit of the company.

**Duty to avoid a conflict of interest and to disclose material personal interests**

All directors must disclose all personal interests that the directors have in relation to the affairs of the company. All directors must, as soon as they become aware of a conflict of interest, notify the board of such conflict.

Directors of proprietary companies, however, need not give notice as to a conflict, provided the other directors are fully aware of the nature and extent of the relevant director's conflicting interests.

The procedure for dealing with conflicts of interest depends on the circumstances and usually requires specialist advice. In some instances, it may be appropriate for a director to disclose a conflict and refrain from voting on the issue. In other instances, the director's resignation may be required.

**Duty not to abuse a corporate opportunity**

Like the duty to disclose material personal interests, a director has a duty to not take advantage of a corporate opportunity for personal gain and at the expense of the company.

Only where such an opportunity is properly considered and rejected by the company can a director pursue the opportunity personally, pending the necessary disclosure requirements.

**Duty of care and diligence**

A director is required to discharge its duties with the same degree of care and diligence that a reasonable person in a similar position would exercise. Factors such as the size of the company and experience, position and responsibilities of the director are considered in establishing this objective standard of care.

A director may not be liable for breach of the duty to exercise care and diligence if the director:

- made the decision in good faith for a proper purpose;
- rationally believed the decision was in the best interests of the company after having made all reasonable inquiries necessary to inform themselves about the subject matter of the decision; and
- made the decision while having had no personal interest in the matter.

**Duty not to engage in insolvent trading**

Each director has a duty to prevent the company from trading while insolvent and to prevent the company from trading in a way that will make it insolvent.

When a company debt is incurred, if a director is aware that or has reasonable grounds to suspect that the company is or may become unable to pay its debts as and when they fall due, the director will be in breach of this duty. The director may become personally liable for the debt and be ordered to pay compensation to the company or its creditors.



A director will be deemed to have been aware of the company's insolvency if a reasonable person in the position of the director would have been so aware.

Other than being ill or otherwise incapacitated, a director will only have a defence if they can demonstrate that there were reasonable grounds on which to expect the company was, and would remain, solvent.

#### **Duty to keep proper accounts and records**

Each director is required to ensure the company prepares a financial report and a directors' report each financial year in accordance with the relevant reporting requirements.

While small proprietary companies may be exempt from lodging all the information required of larger companies, each director must inform themselves of accounting and recording obligations. Specialist accounting advice is usually necessary and recommended.

#### **3.3 Requirements for local shareholding**

Unlike other jurisdictions, there are no requirements for an Australian company to have a local shareholder. The company can be fully owned by a foreign company.

#### **3.4 Minority shareholders' rights and protection**

The issue of shareholder's rights and protection in Australia is complex. Two of the most important considerations in this respect are listed below.

#### **Oppression of minority shareholders**

There are far-reaching remedies set out in section 233 of the *Corporations Act 2001*(Cth) for oppression of minority shareholders. The concept is generally used in reference to conduct falling under section 232 of the *Corporations Act 2001* (Cth). The practical implication is that oppression occurs where a

minority shareholder is treated unfairly by majority shareholders who misuse their influence and control over the company. Oppression of minority shareholders can lead to different orders including an order that the company be wound up.

#### **Right to call a general meeting**

One or several shareholders with at least 5% of the votes may request to call a general meeting in accordance with section 249D of the *Corporations Act 2001* (Cth).

### **4. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions**

#### **4.1 Barriers to entry for an offshore party**

Certain foreign investments, for example certain real estate investments and significant businesses investments, must be approved by the Foreign Investment Review Board (FIRB) before they may proceed. Certain other investments (for example in defence or media companies) also require FIRB approval. Other than that, there are no significant barriers to entry for an offshore party. As mentioned above, a Pty Limited company needs to have at least one director who resides in Australia, but there are no local shareholding requirements.

#### **4.2 Capitalisation obligations**

There are no minimum capital requirements for the incorporation of a Pty Limited company.

Foreign entities investing in Australia are subject to thin capitalisation rules that govern the level of debt-to-equity a company must hold. This means that the amount of debt used to fund Australian operations must be limited. The thin capitalisation rules prevent an entity from claiming a deduction for expenses incurred relating to this debt (debt deduction), such as interest payments.





However, inward investing entities are not affected by the thin capitalisation rules if their debt deductions, including those of any associated entities, are A\$2 million or less for the income year.

#### **4.3 Business or investment visa**

Significant restrictions apply to foreigners which want to obtain a work visa in Australia. There are many different visa classes which may apply such as the ETA Visa, the Class 188 Visa, the Class 400 visa and the Class 457 Visa. At the time of writing of this guide (August 2017), the Class 457 Visa is the most frequently used long-term visa in Australia. However, the Australian Government has announced that the Class 457 visa will significantly change in 2018. Immigration and work permits are a political topic in Australia

and the rules governing visas are expansive and change constantly. It is advised that any person wishing to enter Australia contacts a registered migration agent to obtain appropriate advice.

#### **4.4 Restrictions on remitting funds out of the jurisdictions (withholdings, etc.)**

There are cash reporting obligations under the *Financial Transaction Reports Act 1988* alongside the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*. It is a requirement to report international currency transfers of A\$ 10,000 or more for the purpose of detecting tax evasion and money laundering.

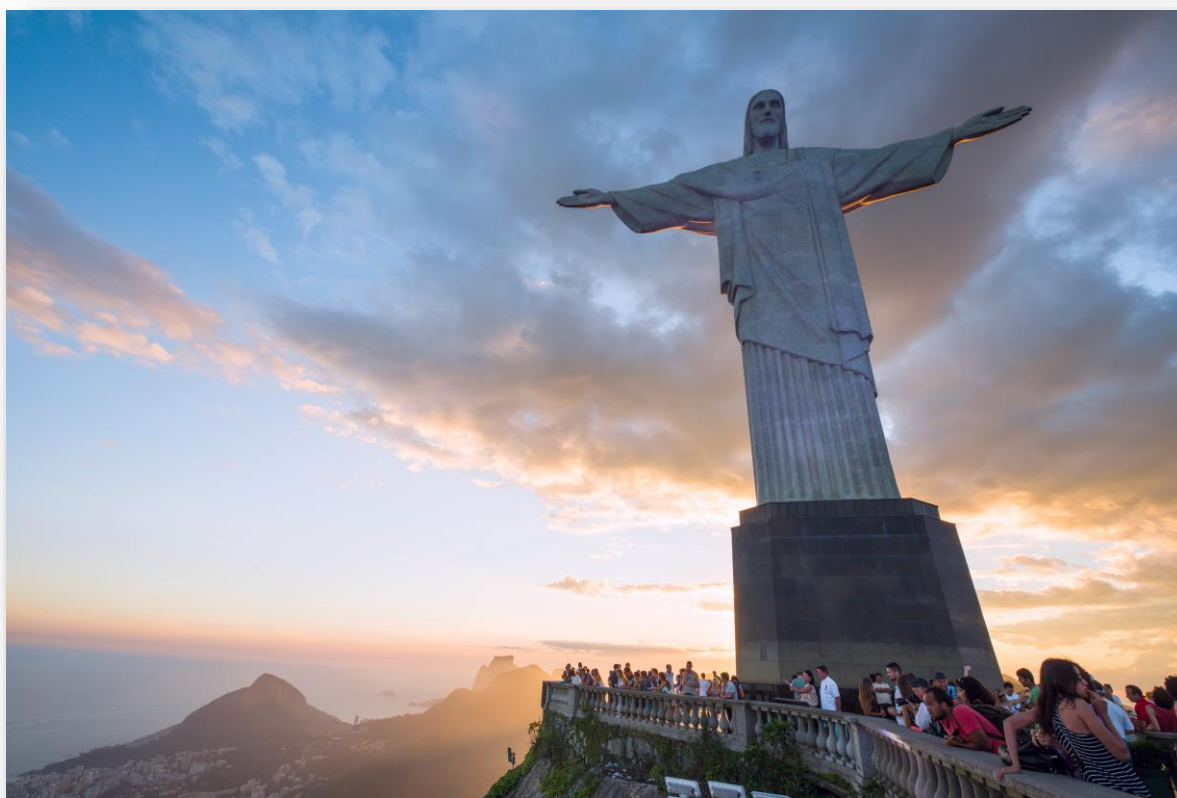
Certain payments (dividends, interest) attract a withholding tax in Australia. Detailed tax advice should be sought on these topics.



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# INTERNATIONAL LAWYERS NETWORK



**KLA – KOURY LOPES ADVOGADOS  
ESTABLISHING A BUSINESS ENTITY IN BRAZIL**



## ESTABLISHING A BUSINESS ENTITY IN BRAZIL

Brazil is composed of 26 states and 1 Federal District and Portuguese is the official language. The legal system of all states and the Federal District is governed by the Civil Law system, derived from the French Napoleonic Code, as reflected primarily in the Civil Code.

Brazil has several levels of government: federal, provincial/territorial and municipal.

### 1. Types of business entities

The two most common types of legal entities adopted in Brazil are the limited liability company (“Limitada” or “Ltda.”) and the corporation (“S.A.”). These are the most convenient types of companies since only in those companies you may find, at the same time, the following advantages: (i) the liability of the equity holders is generally limited to their equity interest (subject to certain specificities described below); (ii) they can be used for any type of business (i.e., services, industry, commerce); and (iii) there is no minimum capital requirements (with few exceptions related to the nature of the activities conducted, not by reason of their corporate type).

Recently, a new type of entity, Eireli (“Empresa Individual de Responsabilidade Limitada”, or Limited Liability Individual Entity) has been created. The Eireli works similarly to a Limitada, but its equity interest shall be held by a single partner, provided that (i) the partner of the Eireli may not be a partner of any other Eireli, and (ii) the capital stock of the Eireli must be equivalent to at least one hundred times the minimum wage in Brazil - which

currently amounts to BRL 937.00 (approximately USD 300).

#### 1.1 Limitada x S.A.: Summary of the most relevant characteristics and the basic differences.

The Ltda. is governed by the Brazilian Civil Code, law 10,406/02 (the “Civil Code”), and the S.A. is governed by the Corporation Law (the “Corporation Law”). The Articles of Association of a Ltda. may provide that the Ltda. shall be subsidiarily governed by the Corporation Law, in which case such law will apply whenever the Civil Code regulations are silent on any subject.

A S.A. may be either publicly or closely held. A publicly held S.A. must be registered with the Brazilian Securities Commission (“CVM”), and has its stock traded in the Stock Exchange. A closely held S.A. is a private entity, which does not issue shares to the public. For purposes of this article, we will consider only the characteristics of a closely held S.A.

The charts below present a comparative analysis of the most relevant characteristics and the basic differences between a Ltda. and a S.A.

**COMPARATIVE CHART BETWEEN THE LTDA. AND THE S.A.**

**A. General Aspects:** In general, the main differences between a Ltda. and a S.A. are the following:

	<b>LTDA.</b>	<b>S.A.</b>
<b>Holders</b>	Holders of the Ltda. are called partners.	Holders of the S.A. are called shareholders.
<b>Governing Documents</b>	The Ltda. is governed by the Articles of Association (“Contrato Social”).	The S.A. is governed by the By-laws (“Estatuto Social”).
<b>Capital Stock</b>	Capital is divided into quotas, which ownership is reflected in the Articles of Association. All quotas must have voting rights and an indicated par value.	Capital is divided into shares, which ownership is reflected in the company’s corporate books; although shares may also be represented by certificates this is no longer a common practice. There may be preferred shares with no or limited voting rights, and there may be shares with or without a par value.
<b>Transfer of Interest</b>	Quotas are transferred through amendments to the Articles of Association. Transfer of quotas to a third party may be opposed by partners representing more than ¼ of the capital stock.	Transfers of shares are registered in the company’s corporate books. No need to amend the By-laws.
<b>Securities</b>	The Ltda. may not issue debentures, warrants and other securities or convertible bonds.	The S.A. may issue debentures, warrants and other convertible bonds (even a closely held S.A., no need to be publicly held).
<b>Minimum Capital</b>	No minimum capital must be paid in at the time of formation of the Ltda.	10% of the subscribed capital must be paid in at the time of formation of the S.A.
<b>Dividends</b>	No minimum dividend payment required. Dividends may be paid disproportionately (no need to be paid according to the partners’ equity interest).	A minimum dividend must be provided in the By-laws (expressed as a percentage of the company’s profits). Payment of dividends must be pro-rata to the shareholders’ equity interest.
<b>Management</b>	At least 1 individual, resident in Brazil.	At least 2 individuals, both resident in Brazil.
<b>Publications</b>	No need to publish financial statements and minutes of Meetings in newspapers unless the Ltda. is considered a “large company” (please see details below).	Publication of financial statements and minutes of Meetings in newspapers is required, with few exceptions.



**B. Partners/Shareholders and Capital Stock**

	<b>LTDA.</b>	<b>S.A.</b>
<b>Partners /Shareholders</b>	Minimum of 2 partners required, individuals or legal entities, Brazilian or foreign. The foreign partners must be represented by a Brazilian resident and will be required to obtain a taxpayer registration number. For the representation in partners' meetings or assemblies, the Brazilian resident must be either one of the other partners or a lawyer.	Same as in the Ltda. Foreign shareholders must be represented by another shareholder, an officer or a lawyer, all residents in Brazil.
<b>Liability</b>	Until the capital is fully paid in, the liability of the partners is limited to the total amount of the capital. After the capital has been fully paid in, the liability of the partners is limited to their equity interest.	The liability of the shareholders will be limited to their equity interest, whether or not the company's capital stock is fully paid-in.
<b>New Partners/ Shareholders</b>	The admission of a new partner may be opposed by partners representing more than ¼ of the capital stock. In addition, the Articles of Association or a partners' agreement may impose limitations and/or rights of refusal for the transfer and sale of quotas.	The By-laws or a shareholders' agreement may impose limitations and/or preference rights for the sale of shares.
<b>Capital Contribution</b>	May be paid in in cash (national currency), credits or assets.	Same as in the Ltda.
<b>Capital Increase/ Preference Rights</b>	Only possible if 100% of the subscribed capital been fully paid in. Partners have the right of first refusal for the subscription of newly issued quotas, pro-rata to their equity interest.	Only possible after ¾ of the corporate capital is paid in. Shareholders have the right of first refusal for the subscription of newly issued shares, pro-rata to their equity interest.
<b>Amendments to the Governing Documents</b>	The following actions, among others, require the amendment of the Ltda.'s Articles of Association and are subject to the approval of partners representing 75% of the capital: <ul style="list-style-type: none"> <li>• Change of the corporate name, address, purposes, or duration of the company</li> <li>• changes to the capital stock (increase or reduction)</li> <li>• changes to management provisions</li> <li>• super majority requirements</li> </ul>	Same as in the Ltda., but the changes to the By-laws require approval of shareholders representing 51% of the capital stock.





**C. Management**

	<b>LTDA.</b>	<b>S.A.</b>
<b>Structure</b>	Minimum of 1 manager.	Board of Officers with at least 2 members (mandatory). May also have a Board of Directors with at least 3 members (optional).
<b>Characteristics of Managers</b>	Managers may be partners or non-partners and must be Brazilian residents (no nationality requirement).	Members of the Board of Officers must be Brazilian residents (no nationality requirement). Members of the Board of Directors may be foreigners and/or non-residents (no nationality requirement). The foreign Directors must be represented by a Brazilian resident.
<b>Board of Directors</b>	There are no specific provisions regarding Board of Directors in a Ltda. and it is not common practice to establish one in a Ltda. If provided in the Articles of Association, such board, in practice, would have a “consulting” function.	In general, not required, but if existing, the Board has a more “robust” purpose, with exclusive functions assigned by law. One third of the members of the Board of Directors may, simultaneously, be members of the Board of Officers.
<b>Control of the Management by Partners/Shareholders</b>	Certain matters (such as spin-offs, mergers, liquidation, etc.) depend on the approval of the partners. Additional limitations to management’s authority may be established in the Articles of Association.	Certain matters (such as spin-offs, mergers, liquidation, etc.) shall be submitted to the decision of the Board of Directors (if it exists) and the Shareholders Meeting. Additional limitations to management’s authority may be established in the By-laws.
<b>Election</b>	Managers are always elected by the partners.	The members of the Board of Directors are always elected by the shareholders. The members of the Board of Officers are elected by the Board of Directors, if it exists; otherwise, the members shall be elected directly by the shareholders.
<b>Board of Auditors</b>	Not mandatory. It may be required under the Articles of Association and, if so, it shall be composed by 3 or more members and their alternates. Members may be partners or non-partners and must be Brazilian residents (no nationality requirement).	Mandatory, but the shareholders may decide, at each Annual Shareholders Meeting, if it will be convened or not. When convened, shall be composed by 3 to 5 members, who may or not be shareholders, may not be an officer or a director and must be Brazilian residents (no nationality requirement).



**D. Other Characteristics**

	<b>LTDA.</b>	<b>S.A.</b>
<b>Partners'/Shareholders' Meetings Quorum</b>	Most important decisions require approval by ¾ (75%) of the capital (including amendments to the Articles of Association, capital contributions, changing the purposes of the Ltda., amalgamation, merger, dissolution, or termination of liquidation of the company). Other decisions, such as approval of the financial statements, may be approved by majority vote. Articles of Association and partners' agreements may establish super majority requirements.	Decisions taken by majority vote. The By-laws and shareholders' agreement may establish super majority requirements.
<b>Meetings' Calls</b>	The Articles of Association may establish the procedure to convene the company's meetings, except if the company has more than 10 partners, in which case the call notices shall be published 3 times, 8 days in advance for the first call and 5 days in advance for a second call. Meeting's calls may be waived if all partners attend the Meeting.	Call notices for Shareholders Meetings shall be published 3 times, 8 days in advance for the first call and 5 days for a second call. Meeting's calls may be waived if all shareholders attend the Meeting.
<b>Publishing Requirements</b>	The need to publish financial statements is <i>c u r r e n t l y</i> under discussion. There is a debate on whether a "large" Ltda. should be required to publish their financial statements. "Large companies", pursuant to a legal definition, are companies or groups of companies under common control with total assets, in the prior fiscal year, exceeding BRL 240,000,000.00 or annual gross revenues exceeding BRL 300,000,000.00. A Ltda. which does not fulfill these conditions is not required to publish financial statements. Minutes of Partners Meetings or Articles of Association, except in specific cases must be filed with the Board of Commerce (such as merger, spin-off, capital reduction and transformation into another corporate type, among others).	Financial statements, Minutes of Shareholders' Meetings and incorporation documents must be published with the Official Gazette and another widely read newspaper.
<b>Audited Financial Statements</b>	Only required for "large companies", as defined above.	Only required for (i) publicly held, and (ii) "large size companies" as defined above.
<b>Case Law</b>	No abundant case law, since the new Brazilian Civil Code was enacted in 2002. Therefore, case law on Ltda.'s is not yet consolidated.	The Corporation Law was enacted in 1976 and, therefore, case law on S.A.'s is consolidated.



## 2. Necessary Information

The incorporation documents shall necessarily contain, at least, the following information:

- (a) Partners/Shareholders. Name and identification of the partners/shareholders. Foreign partners/shareholders need to obtain a taxpayer registration in Brazil (a simple procedure).
- (b) Name of the Company. In the case of the Limitada, it must include the company's main activity (one word is sufficient).
- (c) Purposes of the Company. The activities to be developed by the Company need to be described. Tax aspects should be observed when specifying the activities to be conducted by the company.
- (d) Complete Address. It is necessary to include the full address of the head office and branches (if any).
- (e) Term of duration. May be either determinate or indeterminate.
- (f) Capital Stock. Amount of the capital, necessarily in Brazilian currency. The capital stock may be paid-in in national currency, credits or assets (in case of the S.A., if payments are in assets, such assets shall be reflected in an evaluation report prepared by an expert, usually an accountant).
- (g) Quotas/Shares. Necessary to establish the number of quotas (Limitada) or shares (S.A.) held by each partner/shareholder and how these quotas/shares will be paid in. Shares of an S.A. do not need to have a par value and may be either ordinary or preferred shares (preference may be related to political or economic advantages). Preferred shares may or may not have voting rights, provided that the number of non-voting shares is

limited to 50% of the total shares issued by the S.A. The Limitada may also have preferred quotas, although not usual.

- (h) Manager. Appointment. Individuals who will act as (i) managers of the Limitada; or (ii) officers of the S.A. and, if applicable (iii) directors of the

S.A., need to be then appointed.

- (i) Dividends. Provision. Necessary to establish how dividends and losses will be allocated among the partners/shareholders.

## 3. Formation Procedures

### 3.1 Limitada

A Limitada is formed in Brazil through the filing of its Articles of Association with the Board of Commerce of the State where the company will have its headquarters. The Board of Commerce of the State of São Paulo takes approximately two to three weeks to file the incorporation Articles of Association and issue certain registrations (described in item 4 below). After the Articles of Association have been filed, the Limitada will be considered as validly existing in Brazil. There is no need to publish the Articles of Association.

### 3.2 S.A.

An S.A. is incorporated through the filing, with the Board of Commerce of the State where the company will have its headquarters, of the Minutes of Shareholders Meeting approving the incorporation of the S.A. and its bylaws. After registration, the Minutes must be published at the State Official Gazette and another widely read newspaper of the city where the company's headquarters are located. The S.A. also needs to open and register certain corporate books.



#### 4. Registrations

After incorporation, the Brazilian company shall obtain the following basic additional registrations, whenever applicable:

- (a) Federal Taxpayer Registration (CNPJ/MF): required for all companies. The registration is obtained simultaneously with the registration with the Board of Commerce, upon the company's incorporation. After such registration, the company will be able to open a bank account and sign contracts. Estimate time for conclusion: approximately 2-3 weeks;
- (b) State Taxpayer Registration: required only for companies involved, directly or indirectly, in the manufacturing or sale of goods. The registration is obtained simultaneously with the registration with the Board of Commerce, upon the company's incorporation. After such registration, the company will be able to issue invoices related to the manufacturing or sale of goods. Estimate time for conclusion: approximately 2-3 weeks; or more in case of manufacturing companies, industries, or other similar companies.
- (c) Municipal Taxpayer Registration (CCM): required for all companies. Estimate time for conclusion: approximately 5 days.
- (d) Municipal Service Tax Registration (ISS): required for companies involved, directly or indirectly, in the rendering of services. After such registration, the company will be able to issue invoices related to the rendering of services. Estimate time for conclusion depends on each Municipality requirements, but average timing is 15 days.
- (e) Ministry of Labor and Social Security registrations: required for all companies. Estimate time for conclusion: approximately 5 days.
- (f) Brazilian Central Bank: required for all companies with foreign partners/shareholders. Estimate time for conclusion: approximately 2 days.
- (g) RADAR (Registration System for Tracking the Activities of Foreign Intermediaries) (import license): The granting of Radar is subject to the confirmation of the existence and the financial and operating capacity of the company. There are three different types of import license: (i) "Express, (ii) "Limited" and (ii) "Unlimited":
  - i. Express Radar. The Express Radar is only applicable to (i) publicly held S.A.; (ii) financial institutions; (iii) governmental entities; and (iv) companies operating export transactions with aggregate amount lower than or equal to USD 50,000, in any period of six consecutive months;
  - ii. Limited Radar. The "Limited" Radar is adequate to companies performing import activities up to USD 150,000 per semester. The procedure to obtain the "Limited" Radar is simpler and only requires the submission of an application request to the Brazilian Federal Revenue Customs Agency. The concession of "Limited" Radar is faster and is not heavily dependent on proof of financial capacity.
  - iii. Unlimited Radar. The "Unlimited" Radar allows foreign trade operations with no value restrictions, but entails recurring analysis of the financial capacity of the importer by customs authorities –based on the level of taxes collected in Brazil by the



importer.

Other specific registrations may be needed depending on the activity to be performed by the company. The registrations are part of the standard routine of a company formation and the whole procedure takes approximately forty-five (45) days, in case there is no manufacture/industrial activities included in the company's purposes. The time for conclusion provided above is an estimate only, which depends entirely on the internal procedures of the applicable governmental entities.

## 5. Basic Tax Aspects to be Considered

### 5.1 Taxation

Brazilian legal entities are individually taxed, without the possibility of tax consolidation, and may be subject to taxes at the Federal, State, and Municipal level of government, according to their activities:

- (a) All legal entities are subject to income taxes (Corporate Income Tax
  - IRPJ and Social Contribution on Net Profit - CSLL). The most common regimes of assessment of these taxes are the so called Deemed Profit and the Real Profit, further detailed below.
- (b) PIS/COFINS, both Federal social contributions, are also generally due by all companies. Their regime varies according to the income tax regime. If the company elects the Deemed Profit regime, PIS/COFINS will be calculated in a simplified manner, with lower rates (3.65%) but no credit offsetting right. If the company elects the Real Profit regime, PIS/COFINS will be paid at a higher rate (9.25%) but the taxpayer will be allowed to offset certain credits.

- (c) ICMS (VAT State Tax) is due upon the sale of goods, and generally vary from 7% to 18%.
- (d) The ISS (Municipal Tax on Service) is due upon the rendering of services and varies according to the Municipality (maximum rate is of 5%).
- (e) The importation of goods and services are also subject to specific taxation. Importation of services are subject to PIS/COFINS at a 12.75% combined rate, and the ISS. Importation of goods are subject to same PIS/COFINS, IPI (Excise Tax), ICMS and Import Duty, depending on the item to be imported.
- (f) Payments abroad are usually subject to a 15% withholding income tax, or 25% if to tax havens or if related to services. Other taxes may apply depending on the nature of the remittance. Remittance of dividends are tax free in Brazil, irrespective of the domicile of the beneficiary.
- (g) The most relevant labor-related taxes are Social Security Contribution (20% on payroll) and Employment Security Fund – FGTS (8% on payroll).

### 5.2 Tax Regimes

There are two basic regimes for calculation and payment of the Corporate Income Tax (IRPJ) and the Social Contribution on Net Profit (CSLL), namely the “Real Profit Regime” and the “Deemed Profit Regime”.

- (a) Real Profit Regime. Companies with total gross revenues greater than BRL 78,000,000.00 per year must assess income tax according to the Real Profit Regime, which is based on quarterly or annual balance sheets.





Other companies subject to the Real Profit Regime of taxation, irrespective of the revenue level, are those: **(i)** involved in financial activities (banks, leasing companies and other financial institutions) or factoring; **(ii)** that have profits or capital gains originated from foreign sources (income from foreign trade or services excluded); **(iii)** that enjoy tax benefits (exemption or reduction of income tax); **(iv)** that made payments under the estimated system during the tax year.

- (b) Deemed Profit Regime. Under this regime, calculation of taxes is simplified. The company must determine its tax basis by applying a statutory percentage to its gross revenues (32% for services and 8% for the sales of goods). The tax rate will apply over such basis.

The rates are the same as in the Real Profit Regime: **(i)** IRPJ of 15%, with an additional 10% on the profits that exceed BRL 20,000.00 per month (i.e., profits of BRL 240,000.00 per year are taxed at a 15% rate, and the exceeding amounts are taxed at a combined 25% rate); and **(ii)** CSLL of 9%.

### 5.3. Transfer Pricing on Foreign Loans and Thin Capitalization Rules

All foreign loan agreements in Brazil are subject to transfer pricing rules, according to which the interest paid to related parties is deductible up to an amount which does not exceed the amount corresponding to:

- (a) the market rate of Brazilian bonds issued abroad in US Dollars, for transactions in US Dollars with fixed rate;
- (b) the market rate of Brazilian bonds issued abroad in Brazilian Reais, for

transactions in Brazilian Reais with fixed rate;

- (c) the Libor rate for 6 months deposits in the currency of the corresponding agreement or in US Dollars for agreements signed under a currency for which a specific Libor rate is not available, for other transactions; or
- (d) the specific rate stipulated by the Treasury Ministry, for transactions in Brazilian Reais with floating interest rate.

In the first three cases above, a 3.5% spread increases the maximum interest rate.

Thin capitalization rules impose additional restrictions on the interest paid on loans to related foreign companies. In general, interest paid to foreign related parties is deductible only if, cumulatively:

- (a) it is a necessary expense for the entity; and
- (b) the amount of the indebtedness with a related company does not exceed twice the amount of the participation of the related entity in the equity of the Brazilian entity (or twice the net worth of the entity, if lender does not hold any participation).

Thus, the Brazilian companies are subject to specific debt/equity ratios, as follows: (a) a debt/equity ratio of 2 to 1, in general, or (b) a debt/equity ratio of 0.3 to 1, in cases the related entity is domiciled in a blacklisted jurisdiction or is subject to a privileged taxation regime.

The debt/equity ratio above must be tested every month, considering both the amount of accrued interest, as well as the net equity of the previous year or month (if available). Profits accumulated during the year may reduce the debt/equity ratio.



Notwithstanding the above, when the company verifies that the ratio is about to reach the limit stipulated by law, it is possible to convert part of the loan into equity. This procedure is simple to implement, but it may trigger IOF in some cases. It may also anticipate the withholding income tax if a portion of due interest is also converted into equity or the recognition of exchange variation gains or losses (in cases where the company elected the cash basis regime).



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# INTERNATIONAL LAWYERS NETWORK



**ROBINSON SHEPPARD SHAPIRO LLP  
FOGLER RUBINOFF LLP  
ESTABLISHING A BUSINESS ENTITY IN CANADA**

**ILN CORPORATE GROUP**



## ESTABLISHING A BUSINESS ENTITY IN CANADA

### INTRODUCTION

#### Bilingual and Bi-Juridical

Canada is a bilingual, bi-juridical, and multi-cultural country, composed of 10 provinces and 3 territories. English and French are federally mandated official languages pursuant to the *Official Languages Act* (Canada). French is the official language in the Province of Québec pursuant to the *Charter of the French Language* (Québec). The legal system of all provinces and territories (other than the Province of Québec) is based upon the Common Law, derived from England. Québec (like the American State of Louisiana) is governed by the Civil Law system, derived from the French Napoleonic Code, as reflected in the *Civil Code of Lower Canada* adopted in 1866 (one year prior to Confederation) and replaced as of January 1<sup>st</sup>, 1994 by the *Civil Code of Québec* (the “CCQ”).

#### Levels of Government and Jurisdiction

Canada has several levels of government: federal, provincial/territorial, and municipal. The allocation of exclusive jurisdiction between the federal and provincial/territorial governments was established under the *British North America Act* of 1867 at the time of Confederation.

Generally speaking, most matters regarding private property, commerce and business fall under provincial/territorial jurisdiction, with the exception of industries such as airlines, marine transportation and pollution, railways and cross-border and extra-provincial transportation and telecommunications, all of which are federally regulated.

The federal government also deals with bankruptcy, competition, foreign investment, criminal and family law, as well as an array of other matters where it is deemed to be acting

“to the general advantage of Canada”, which is an ongoing source of friction between the federal government and the various provinces and territories.

### TYPES OF ENTITIES AVAILABLE IN CANADA THROUGH WHICH TO CONDUCT BUSINESS

#### Corporations

In Canada, one may incorporate federally under the *Canada Business Corporations Act* (the “CBCA”), or under the corporate statute of a particular province or territory. Most provinces and territories, including most recently the Province of Québec, have adopted Business Corporations Acts which largely mirror the CBCA.

Generally speaking, one would incorporate under the CBCA if one expects to carry on business in more than one Canadian province or territory. Alternatively, one would consider provincial or territorial incorporation if it is anticipated that the operations will be limited to that jurisdiction, as there are savings to be achieved by making corporate filings and otherwise complying only with the provincial/territorial rules, rather than filing annual returns and other notices at both the federal and provincial/territorial levels.

Canada also has statutes governing the formation and operation of non-profit entities at both the federal and provincial/territorial levels.

#### ULC

Unlimited liability companies (ULC’s), which are similar to American limited liability companies (LLC’s), can currently be formed only in the Provinces of Nova Scotia, British Columbia, and Alberta. These entities permit flow-through treatment for profits and losses to their shareholders under U.S. tax law (and are



sometimes known as “check the box” entities, on the basis of the election they can make to retain their corporate identity but be taxed as if they were partnerships). However, the Canadian versions do not provide limited liability protection, and it is therefore common practice to interpose a single-purpose holding corporation between the ULC and the ultimate shareholder(s).

**Partnerships / Limited Partnerships**

These are formed under provincial/territorial law in each case and generally governed by such laws and the particular partnership or limited partnership agreement (as the case may be). Typically, in a limited partnership, the general partner (which is often a shell



corporation) is responsible for all the obligations and liabilities of the limited partnership. The liability of the limited partners is restricted to the amount of their respective contributions, provided that they do not become involved in the management of the limited partnership. To retain limited liability protection, the limited partner must remain a passive investor rather than an active participant in the operation of the limited partnership.

**BRIEF OVERVIEW OF STEPS TO INCORPORATE/CONSTITUTE EACH TYPE OF ENTITY**

**Corporations / ULC**

Both federal and provincial/territorial corporations and ULCs (where permitted) are formed by filing articles of incorporation and notices of directors and head office with the applicable government authority.

Unless an automatically assigned numbered corporation is desired, the proposed name must be searched to ensure it would not result in confusion with already existing entities. In the case of a CBCA (federal) incorporation, the name must also not create confusion with any registered trademarks or pending trademark applications, as intellectual property (patents, trademarks, copyright, and industrial designs) is also a matter of federal jurisdiction in Canada. An expanded search which includes trademarks and may also extend to domain names is not required in other jurisdictions, but is advisable to ensure that a business does not need to later change its name after having built up a brand.

Once incorporated by the issuance of a certificate of incorporation by the applicable government authority, the corporation or ULC must then be “organized” by: (i) the issuance of shares, (ii) the adoption of general, banking and borrowing by-laws, (iii) the confirmation, replacement, or addition to the board of directors by the new shareholders and their ratification of the by-laws and (iv) the nomination by the directors of the various officers. Multiple shareholders may enter into an agreement governing the operations of the corporation or ULC. They may also shift some or all of the powers and related liabilities of the board to the shareholders (known as a “unanimous shareholders’ agreement,” not because all of the shareholders are party to it,





but because of its effect on the decision-making process).

### **Partnerships / Limited Partnerships**

These are generally formed by the agreement of the partners in the case of a general partnership, or the general and limited partners in the case of a limited partnership. General partnerships do not usually require any other formality in order to be created, whereas a limited partnership generally exists only from its registration date. The partnership agreement or limited partnership agreement, as the case may be, takes the place of the certificate and articles of incorporation and by-laws, and will govern the issuance of partnership units and the operations of the entity.

### **BRIEF SUMMARY OF REGULATION OF EACH TYPE**

#### **Provincial/territorial registration**

Any business incorporated under the laws of Canada, or a particular province or territory, which wishes to carry on business in another jurisdiction must be registered or licensed in that additional jurisdiction. While the definition of "carrying on business" varies slightly from one jurisdiction to another, there are usually factual tests based on having a physical presence in the jurisdiction, including having an office, employees who report to work there, or a local telephone listing, without the mind, management and control of the entity necessarily being there. A partnership or limited partnership generally must be registered as carrying on business in the jurisdiction and file annual and updating returns or reports.

A trust carrying on a commercial enterprise, such as a business, investment or real estate trust (whether or not profitable), which is not

managed by a registered trustee (such as a trust company) must also register with the Québec Register of Enterprises in the same manner as a sole proprietorship, partnership, or legal person (corporation) within 60 days of beginning operations.

#### **Securities Law**

Securities law is a matter of provincial/territorial jurisdiction and each province or territory therefore has its own regulator. Unlike the other G7 countries, there is no federal regulator akin to the U.S. Securities and Exchange Commission. It should be noted, however, that the federal Minister of Finance strongly supports the adoption of a single national securities regulator, as does the International Monetary Fund and the Ontario Securities Commission (Ontario being Canada's largest capital market). Currently, the 10 provinces and 3 territories in Canada are responsible for securities regulations. Securities regulators from each province and territory have teamed up to form the Canadian Securities Administrators, or CSA for short. The CSA is primarily responsible for developing a harmonized approach to securities regulation across the country. In recent years, the CSA has developed the "passport system", through which a market participant has access to markets in all passport jurisdictions by dealing only with its principal regulator and complying with one set of harmonized laws. It is a major step forward in improving Canada's securities regulatory system by providing market participants with streamlined access to Canada's capital markets.

In Canada, shares and other securities to be issued by any organization may only be issued through a qualified prospectus. There are, however, broad exemptions from this prospectus requirement.



National Instrument 45-106 (adopted in Québec and Ontario as Regulation 45-106, and hereinafter “NI 45-106”), sets out the prospectus exemptions, and replaces the exemptions previously found in the provincial/territorial securities legislation. The national rules extend the application of the provincial and territorial securities legislation beyond shares in the capital stock of companies to all securities, excluding only non-convertible debt securities. Thus, warrants, options and convertible debentures are covered by the securities rules, as opposed to only the underlying shares if and when they are exercised.

In order to qualify for an exemption from the prospectus requirement under NI 45-106 as a private issuer, either the charter documents of the corporation or an agreement among all security holders must: (i) permit a maximum of 50 shareholders (not counting former or current employees, directors or officers); (ii) impose restrictions on the free transfer of all securities (such as board or shareholder approval); (iii) prohibit any distribution of securities other than to the permitted categories of potential security holders (generally the founders, directors and officers and their respective family members, close personal friends and close business associates), as well as those who qualify as accredited investors (generally institutions or high net worth individuals or entities).

The accredited investor exemption will apply to individuals in several circumstances, including: (i) individuals, either alone or with a spouse, having financial assets (generally cash or securities but not real estate or non-financial personal property) with net pre-tax realizable value of over \$1 million; (ii) individuals, either alone or with a spouse, having net assets of at

least \$5 million; (iii) individuals with net pre-tax income in each of the last 2 calendar years over \$200,000, or \$300,000 together with a spouse, and a reasonable expectation of higher income in the current calendar year. A risk acknowledgement form is required to be completed and signed by individual accredited investors, except those who qualify as permitted clients (as defined in NI 31-103). Investors must indicate in the form how they meet the criteria for an accredited investor. The form also requires identification of any salesperson who meets with or provides information to the investor with respect to the investment. If the accredited investor requirements are not met, the corporation will not be a private issuer and must file a prospectus in order to issue shares or deal in (*e.g.*, transfer) its shares, unless another exemption under NI 45-106 is available.

Most of the other exemptions require that a filing be made with the securities regulators in each province or territory in which affected shareholders are situated, which can entail significant fees being payable in the event of a large financing. This would also pose a serious problem in the event that a potential purchaser or investor wishes to obtain an opinion that the target company is indeed a private issuer, and that all securities legislation and regulations have been complied with as a pre-condition to concluding a particular transaction, as is customary in Canadian deals.

### **Employment Law**

In general, Canadian employment law is much more protective (if not overtly biased in favour) of employees than its American counterpart. Both provincial/territorial and federal privacy laws protect an employee’s right to privacy and personal information. Employee rights are enshrined in the *Canada Labour Code* and the



*Canadian Human Rights Act* and their various provincial and territorial counterparts across Canada. This legislation prohibits any form of discrimination in the hiring and treatment of employees.

Acts and policies which are taken for granted in the United States (such as drug testing and video or other forms of electronic surveillance, including monitoring of electronic or telephone communications) must be carefully reviewed to ensure compliance with Canadian laws, which are more stringent in these regards.

In many jurisdictions (including the Provinces of Ontario and Québec), the purchaser of a business is deemed to be a continuing employer and inherits the employees and their current employment rights, including compensation, seniority, vacation, and other benefits. There is no concept under Canadian law of “employment at will”. An employee's tenure with a predecessor corporation will be considered for the purposes of determining termination pay required by the employment standards legislation and for determining the amount of reasonable notice which must be given on termination of employment without cause. However, written contracts may reduce, but not entirely eliminate, the non-statutory notice and severance requirements.

Under Canadian law, non-competition and non-solicitation undertakings are seen as a restraint of trade, and are more restrictively interpreted and applied in an employment context than in the context of the sale of a business. Non-competition undertakings will generally be enforced if the scope of the activities covered, the geographical territory and the period of time for which the restrictions are to remain in force are all reasonable in light of the employer's legitimate need to protect its business interests. Further, an ambiguous

restrictive covenant is *prima facie* unreasonable and will be unenforceable. The Supreme Court of Canada also recently decided that non-solicitation undertakings are not subject to the same restrictions.

The Canadian courts will not generally write down an invalid clause and will invalidate a non-compete undertaking where they find that a non-solicitation undertaking would have sufficed. In Québec, however, an employer cannot enforce a non-competition undertaking if the employer either terminated the employment without “serious reason” or gave the employee “serious reason” to resign from the employment (CCQ 2095).

## **Privacy Rights and Data Protection**

### Privacy

Canada's federal privacy and data protection law applicable to the private sector is the Personal Information Protection and Electronic Documents Act (PIPEDA). PIPEDA applies to private sector organizations that collect, use, and disclose personal data (called “personal information” (PI) in Canada) in the course of a commercial activity that takes place within a Canadian province or territory, unless the province has enacted “substantially similar” legislation. Such legislation is in force in 3 provinces: Alberta's Personal Information Protection Act (PIPA AB); British Columbia's Personal Information Protection Act (PIPA BC); and Quebec's An Act Respecting the Protection of Personal Information in the Private Sector (Quebec's Privacy Act). In 2013, Manitoba enacted a private sector privacy statute entitled the Personal Information Protection and Identity Theft Prevention Act (PIPA Man) but it is not yet in force. Notably, PIPEDA also applies to the inter-provincial and international collection, use and disclosure of PI. PIPA AB, PIPA BC and the Quebec Privacy Act apply to



the privacy and data protection practices of organizations within Alberta, BC, and Quebec, respectively, which are not otherwise governed by PIPEDA. In Ontario, PIPEDA is the only privacy and data protection law applicable to private sector organizations. Canada also has privacy and data protection laws specific to the health sector and to the public sector.

### Anti-spam

Since July 1, 2014, the anti-spam provisions of Canada's Anti-Spam Legislation (CASL) have required the sender of a commercial electronic message ("CEM") sent from or to a computer system in Canada:

1. to have the consent of the CEM recipient ("Recipient");
2. to identify the CEM sender; and
3. to provide an unsubscribe mechanism.

CASL defines a CEM as any electronic message (including an email, short service message (SMS) text, or social media message) that, reasonably construed, has as one of its purposes encouraging participation in a commercial activity. A CEM includes any electronic message used to promote a business or a business opportunity. Unless a CASL exemption applies, a CEM may be sent to a contact only with their prior express consent or implied consent.

Even a single, first contravention of CASL could result in a penalty of up to \$10 million for a corporation and a penalty of up to \$1 million for the individual involved (which includes not only the individual CEM sender but anyone who aids, induces or procures a contravention). In addition, the CASL regulators may publicly identify the sender as having contravened CASL which would embarrass the sender and harm its reputation.

If CASL's private right of action ("PRA") ever comes into force, CEM senders who contravene CASL may also be subject to possible class actions and significant damages awards (based on damages for actual loss and on statutory damages of \$200 per contravention up to a maximum of \$1 million per day). That said, by Order in Council published June 7, 2017, the federal government indefinitely suspended the coming into force of the PRA (which had been scheduled to come into force on July 1, 2017). In its press release regarding the suspension of the PRA, the federal government confirmed it will ask a parliamentary committee to review CASL in keeping with the existing provision of CASL which calls for such a review any time after July 2, 2017.

### **Consumer Protection Legislation**

Each province and territory has its own consumer protection legislation, which must be carefully examined if a foreign business which deals with the consumer market wishes to establish a Canadian presence.

Depending on the nature of the business, certain permits may be required, and certain types of contracts must be made in writing and in some cases, in a prescribed form. Consumers have certain statutory rights of rescission (cancellation) of many types of contracts within prescribed delays, which compel the business to accept the cancellation of the contract and refund any amounts already paid.

The types of businesses governed by the *Consumer Protection Act* of various provinces and territories include contracts of sequential performance (such as education services and fitness studios), contracts for the provision of credit, long-term leases of goods, contracts for the sale or repair of automobiles and motorcycles, and sales by itinerant vendors.



Under the *Competition Act*, which applies to all of Canada, a person who promotes the supply/use of a product or any business interest, or who conducts any contest, lottery, game of chance or skill, or mixed chance and skill, will be considered to have engaged in reviewable conduct where: (i) adequate and fair disclosure is not made of the number and approximate value of the prizes, the area(s) to which they relate and of any fact that materially affects the chance of winning; (ii) distribution of the prizes is unduly delayed; or (iii) selection of participants or distribution of the prize is not made on the basis of skill or on a random basis.

Québec also has its own rules governing publicity contests where the aggregate prize value exceeds \$100. The contest rules must be translated into French (although they may also be in another language) and filed with the *Régie des alcools, des courses et des jeux*, along with payment of a fee based on a percentage of the aggregate prize value, and a report once the contest is closed confirming the prize awards.

### **Québec Charter of the French Language**

French is the official language in the Province of Québec, although other languages (such as English) may be used in certain circumstances and under certain conditions. Legislation and regulations are published in both French and English, and both versions have equal ranking. Parties may use either language before the courts and may request a translation of any decision rendered by any court or any quasi-judicial tribunal or body, at the government's expense. However, French remains the official language of government, as well as all para-public organizations, including professional orders.

Employees have the right to work in French, and knowledge of another language cannot be made a prerequisite of employment unless it can be justified by the nature of the person's duties and functions. Workplace communication must be in French, although it may also be in other languages as well. Businesses in Québec employing 50 or more people must obtain a francization certificate attesting to their use of French in the workplace, which must be confirmed by triennial reports. Businesses employing 100 or more people must establish a francization committee composed of management and employees, with the mandate of ensuring French is used in the workplace.

Publicity and advertising must be in French. Other languages may be used, provided that no inscription in another language is given greater prominence than that in French. For example: signage on the sides of motor vehicles, such as delivery trucks, which venture onto the territory of the Province of Québec (even if they are licensed elsewhere) must be in French; markings on products intended to be sold in Québec must be in French but may also be in another language; and software offered for sale in Québec must be available in a French version upon no less onerous conditions. The web site of any business conducted in Québec must operate in French, regardless of its head office location or where the web site is hosted or controlled, but may also operate in other languages, if so desired. There have been several recent decisions imposing fines for contraventions of these rules, although the resulting adverse publicity arguably has a more immediate impact.

In order to obtain provincial/territorial registration to carry on business in the Province of Québec, the entity must register and operate





under the French version of its name. If the English element is trademarked and it can be demonstrated that the name cannot be readily translated (for example, “Second Cup” does not work quite as well as “*Deuxième Tasse*”), the English trademark may be used but must be accompanied by a French element (such as, “Café Second Cup”).

All commercial advertising on billboards, signs, posters or other media having an area of 16m<sup>2</sup> or more and visible from any public highway, other than a sign on the firm’s premises, or on or in any public transportation or accesses thereto (including bus shelters) must be in French only; however public signs and posters on or in a vehicle regularly used to transport passengers or goods (such as a delivery truck) both within and outside Québec may be in both French and another language, provided the French is displayed at least as prominently (as defined by the Regulation respecting the language of commerce and business, the “Regulation”).

Furthermore, in 2016, the Quebec government amended the Regulation to require that all signs and posters displaying trademarks in a language other than French also contain a French generic term, descriptive element, slogan or other information about the products and services offered. This new rule applies to all signs and posters “outside an immovable” (or building), which includes signs or posters outside premises located within a larger building (for example a store or kiosk in a shopping centre) or inside a building but designed to be seen from the outside. The French content must have a “sufficient presence”: it must be permanent, with similar visibility and equal legibility in the same visual field (e.g., size, color, lighting) to the non-French content, and this will be assessed based

upon the position from which the signage is intended to be viewed (e.g., from a sidewalk, the centre aisle of a shopping centre or a highway). The new regulations apply immediately to all new signs and posters as well as replacements of existing signs and posters; however businesses will have 3 years to comply for existing signs and posters as well as for trademarks already used on signs and posters as part of a franchise system or where the proposed sign or poster has been the object of either an application for or the issuance of a municipal or analogous government permit in the 6-month period preceding the adoption of the regulation.

Adhesion (non-negotiable) and standard form contracts, as well as any annexed documents, must be drafted in French, unless the parties expressly agree otherwise. It is for this reason that one commonly sees a clause in any contract involving one or more Québec parties, whether or not it was in fact negotiable, to the effect

that:

*“The parties have requested that this Agreement and all documents ancillary thereto be drafted in English. Les parties ont exigé que la présente convention ainsi que tout document ancillaire soient rédigés en anglais.”*

## **MATTERS TO BE CONSIDERED BY AN OFFSHORE PARTY WHEN SELECTING BUSINESS ENTITY TYPE**

### **BARRIERS TO ENTRY**

#### **Competition Act**

A foreign investor must consider the *Competition Act* (Canada), which is analogous to US antitrust legislation, when seeking to acquire an interest in a Canadian business, either by acquiring assets or shares.

The first step, in any acquisition, is to determine whether the acquirer and target, on



a consolidated basis (including their respective affiliates), will have CDN \$400 million or more in aggregate asset value or gross revenues after completing the transaction. If so, the second step is to determine whether (a) in an asset deal, the aggregate value of the Canadian assets to be acquired or of the annual Canadian sales generated by such assets exceeds the annual threshold (set for 2017 at CDN \$88 million), or (b) in a share deal, the aggregate value of the Canadian company whose shares are to be acquired or of the annual Canadian sales generated by such company exceeds the annual threshold (set for 2017 at CDN \$88 million). If so, then in both cases pre-notification is required and the acquirer must receive the approval of the Competition Bureau before it may proceed with the transaction.

Even if the financial threshold is not met, the transaction will be reviewable if it is found not to be in the public interest or to create a concentration which would unduly reduce competition. Furthermore, the Competition Bureau always retains the right under Section 92 of the *Competition Act* to review any transaction where there is a lessening of competition; however, where the transaction is non-notifiable, the Competition Bureau will generally only learn of it if a third-party complaint is made.

The statutory exceptions to the application of the *Competition Act* include acquisitions of public companies or real estate, and transactions made in the ordinary course of business.

The approval may be conditional upon the divestment by the acquirer and/or target of certain businesses, but generally speaking the Competition Bureau favours structural remedies over behavioural ones.

### **Investment Canada Act**

A non-Canadian establishing a new business in Canada or acquiring control of an existing Canadian business must also consider the *Investment Canada Act*. Any investment by a non-Canadian to establish a new business is subject to notification, either prior to implementation or within the following 30 days. The information required includes the identification of the investor, the projected number of employees at the end of the 2nd full year of operation, the projected amount to be invested in the new business over the first 2 full years of operation, and the projected level of annual sales or revenues during the 2nd full year of operation.

The acquisition of control (as defined by certain statutory formulae) of a Canadian business is reviewable if the assets of the entity or entities being acquired exceed certain thresholds. Luckily for members of the World Trade Organization (WTO), the usual thresholds of CDN \$5 million for direct investments and CDN \$50 million for indirect investments are replaced by an annually prescribed amount based on a comparative of the Canadian GDP (gross domestic product) in the current year to that of the previous year. The prescribed amount for 2017 has been set at CDN \$379 million. Even though such transactions are not automatically reviewable, notification of the transaction to the Canadian government along with the filing of forms under the *Investment Canada Act* is required, either prior to or within 30 days after the completion of the transaction. Any acquisition by a WTO investor (other than a state-owned enterprise) of a Canadian business having an enterprise value in excess of \$1 billion (increased as of June 22, 2017 from \$800 million) may also be reviewed to determine the “net benefit to Canada.”



Certain transactions are automatically reviewable without consideration of any threshold, such as the acquisition of control by a non-Canadian of any Canadian business which is engaged in the production of uranium, or is a cultural business. Businesses involved in mining, oil, water and defense and satellite technology are also subject to more stringent requirements.

A "cultural business" is defined by Section 14.1 of the *Investment Canada Act* as the publication, distribution and sale of books, magazines, periodicals or newspapers in print or machine readable form (other than merely printing or typesetting them); the production, distribution, sale or exhibition of film or video recordings, audio or video music recordings, music in print or machine readable form or radio communication in which the transmissions are intended for the general public; and radio, television and cable television broadcasting undertakings, satellite programming and broadcast network services.

Pursuant to recent amendments to the *Investment Canada Act*, the government has been granted additional powers to block transactions involving national security issues, as well as to review transactions involving state-owned entities.

### **Immigration**

The *Immigration and Refugee Protection Act* (IRPA) (Canada) permits a foreign national to apply for a work permit, if necessary, where they will be engaging in "work" in Canada. Work permits are assessed and issued under one of the following programs: 1. International Mobility Program (IMP); or 2. Temporary Foreign Worker Program (TFWP). The IMP allows for foreign nationals to apply for a work permit directly to Immigration, Refugees, and Citizenship Canada (IRCC). Most IMP work

permit categories are based on reciprocity and multi/bilateral agreements with other countries, such as the North American Free Trade Agreement and the General Agreement on Trade in Services. The IMP is primarily for high-skilled and high-wage occupations; however, it also includes work permits under the working holiday category. Work permits issued under an IMP category are usually employer-specific, however some categories allow for open work permits, including spousal work permits and post-graduate work permits. All employer-specific work permits under the IMP require an Offer of Employment through an online employer portal prior to the submission of a work permit application.

The Temporary Foreign Worker Program (TFWP) is managed by Employment and Social Development Canada (ESDC) and is based on employer demand to fill specific positions. Employers must demonstrate that they have made efforts to find a Canadian for the position before filing a Labour Market Impact Assessment (LMIA) application with ESDC to support the foreign national's job offer. As it is an employer-driven process, an LMIA approval allows a foreign national to apply for an occupation and employer-specific work permit. Foreign nationals who require a visa to travel to Canada must file their work permit application at a visa post. Visa-exempt applicants may apply for their work permits at the port of entry.

IRCC does allow limited categories of business visitors to work in Canada without a work permit, including, but not limited to: (i) some commercial speakers, seminar leaders and guest public speakers; (ii) some performing artists, athletes, sports officials, journalists, clergy and providers of emergency services; (iii) diplomats, consular officers and other



representatives or officials of other countries;  
(iv) expert witnesses or investigators.

Additional procedures apply for foreign workers who intend to work in many jurisdictions, notwithstanding that immigration is a matter of federal jurisdiction. It is an offence for Canadian employers to hire anyone who is not authorized to work in Canada.

Canada has introduced a rigorous employer compliance program that requires employers to keep all documentation for a foreign worker on file for a minimum of six years. All employers who have foreign national employees with employer-specific work permits are subject to an inspection or employer compliance review. Employers may be selected randomly or based on a complaint. In December 2015, the government introduced a system of administrative monetary penalties (AMPs) and varying bans on employers in order to address employer non-compliance with the TFWP and IMP employee conditions. The AMPs range from \$500 to \$100,000 depending on the size of the employer, the severity of the violation and the number of previous violations. Employers may also be subject to a ban on hiring foreign workers for a limited or indefinite period of time, or a warning where justification for the non-compliance is accepted.

**The North American Free Trade Agreement Implementation Act (S.C. 1993, c. 34, hereinafter "NAFTA")**

Under NAFTA, citizens of Canada, the United States and Mexico can gain quicker and easier

temporary entry into the three countries to conduct business-related activities or investments. All provisions are equally available to citizens of the three countries. Permanent residents of these countries who are not citizens are not covered by the NAFTA provisions. NAFTA applies to four specific categories: (i) business visitors, (ii) professionals, (iii) intra-company transferees and (iv) persons engaged in trade or investment activities, all of whom can apply to enter Canada on a work permit or as a business visitor without the need for a LMIA. It should be noted that the United States triggered a renegotiation of NAFTA, for which it has imposed a December 31, 2017 deadline. The items being discussed include labour, specifically Canada's proposal for the uniform imposition in Canada, USA and Mexico of more stringent employment standards, as well as an end to US "right to work" legislation (which assert workers' right to enjoy the advantages of unionization without having to join or pay dues to a union) currently in effect in 28 US states.

**CONCLUSION**

As can be seen from this summary review, although the commercial considerations involved in establishing and operating a business in Canada are substantially the same as in other jurisdictions, specific knowledge of the particularities of Canadian business law at the federal, provincial and territorial levels is essential to carrying on that business successfully in the "Great White North."





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# INTERNATIONAL LAWYERS NETWORK



**VGCD ABOGADOS  
ESTABLISHING A BUSINESS ENTITY IN  
COLOMBIA**





## ESTABLISHING A BUSINESS ENTITY IN COLOMBIA

### ABOUT US

VGCD is a Colombian firm created to offer legal consulting services to national and international clients that require the highest quality, efficiency, creativity, and client proximity standards.

Our partners are characterized by a close and long-term relationship with their clients and by the resolute commitment of personally coordinating the projects and issues that are entrusted to them. VGCD has a group of lawyers with national and international academic education, and ample experience in national and international law firms, real economy companies, financial institutions, and public agencies.

Our local and foreign clients are leaders in diverse sectors of the economy, including the financial and insurance sector, oil and gas, automotive, agrochemical, communications, transport, defense and private surveillance, internet, information technology, large retail outlets, medical services, consulting and investment banking services, infrastructure, construction, mass market and entertainment.

#### 1. Preliminary Considerations:

In Colombia, a foreign company can act and do business by itself, for example, by contracting with local entities or investing foreign currencies. Entering contracts, such as joint ventures, with local corporations or persons, depends on commercial negotiations, more than on legal requirements. Foreign investment, on the other hand, is subject to different regulations and the Central Bank supervises the activities (more information below). However, when a foreign company, not only has investments in Colombia, but also desires to perform “Permanent Activities” in its

territory, legal provisions require it to establish a branch or a subsidiary in Colombia (Article 471 of the Commercial Code). Colombian legal provisions do not provide general criteria for what should be understood as “Permanente Activities”, however article 474 of the Commercial Code contemplates a list of activities that are considered as permanent, which are:

1. “Opening commercial establishments or business offices, even if they only provide technical or consulting services.
2. Intervene as a Contractor in the execution of works such as a construction, or rendering of services.
3. Participate in any way in activities of management, use or investment of funds from private savings.
4. Engaging in the resources extraction industry and/or any of its areas or services.
5. Obtain from the Colombian Government a concession, being assigned a concession or participate in the exploitation of one.
6. The conduction of shareholders' meetings, boards of directors, management or administration in the national territory”.

The performance of any of the above activities usually implies the execution of other related activities such as hiring employees, owning, or renting physical premises and other services, which suggests that there is an intention of conducting permanent activities in Colombia. This will result in the obligation to constitute a branch or a subsidiary company in Colombia. In both scenarios, the local vehicle will necessarily have to observe Colombian provisions, which



include compliance with capital contributions and dividend distributions. A capital contribution or the designation of an amount of assigned capital is simply a contribution of capital, in the form of money or property. A dividend distribution refers to the distribution to the parent company or shareholders of the local vehicle, of its net profits earned in the last financial year, after deducting any reserves or deficit carried forward from earlier years.

## 2. Elements of a Branch Office:

First, we would like to establish that a branch office is not considered an independent legal entity, but an extension or commercial establishment of its home office. The branch is considered as a legal entity, which for purposes of its activity must comply with all Colombian regulations. Taking this into consideration, under Colombian provisions, the establishment of a branch office will require the assignment of the following elements: (i) the purpose of the company which in Colombia is known as “objeto social;” (ii) the domicile of the company; (iii) The term of duration of the branch office and the causes for termination; (iv) An initial Capital Contribution to the branch office, which must be paid in full when it is first established; (v) designate a general agent with one or more alternates, whom will represent the company in all of the business deals to be celebrated in Colombia; (vi) designate an auditor, whom must reside permanently in Colombia.

The capital contribution will not be understood as the payment of equity as in an ordinary subsidiary, but it will enter the branch assigned capital for the development of its operations. The designation of the amount of assigned capital must be paid in full when it is first established and since its source is a foreign company it will be considered as a foreign

investment and as such it must comply with the obligatory registration in the Bank of the Republic within the next three months since the reimbursement of the assets is effectuated. There is no minimum capital required for the incorporation of an Office branch in Colombia, however any increase of the assigned capital of a branch requires an amendment of the incorporation document by the pertinent corporate body abroad. The amended document must be formalized by a public deed in Colombia. However, the branch may alternatively receive supplementary investment to its assigned capital from its home office abroad. In this case, the supplementary investment does not alter the assigned capital of the branch and therefore does not require an amendment to the incorporation document. The funds will be registered in the branches “supplementary investment to assigned capital” account, which is managed as a current account between the branch and its home office. The only formality required is the registration of all supplementary investments received from the home office in the preceding financial year, which in conclusion results in a very easy method to finance the office branch. Please note that Article 490 of the Commercial Code establishes that in no case the effective capital of the branch may decrease to an amount inferior to 50% of its assigned capital.

For the distribution of dividends, since the branch office is not an entity with independent judicial capacity but an extension of the foreign company, there is not a dividend distribution as such, but a distribution of its net profits at the end of the corresponding financial year, prior approval of the applicable superintendence (Article 496 of the Commercial Code). These net profits may only be disbursed if the branch has complied with the legal reserve provision

established in article 452 of the Commercial Code.

### 3. Elements of a Subsidiary Company

For the establishment of a subsidiary company, the investor must choose the appropriate corporate form. Colombian provisions establish several forms of association. However, it is common for foreign investors to take the form of a limited liability company, a simplified shareholding company or a corporation as a mechanism for their activities in Colombia. Nonetheless, for tax purposes abroad, sometimes investors prefer to adopt corporate forms that relate to collective associations, such as the "company limited by shares" (*Sociedad encomandita por acciones*). The main characteristics of all these entities are described below.

#### (i) Corporation (*Sociedad Anónima – S.A*)

Under Colombian provisions, the establishment of a Corporation will require the assignment of the following elements: **(i)** the purpose of the company which in Colombia is known as "objeto social;" **(ii)** the domicile of the company; **(iii)** The term of duration and the causes for termination; **(iv)** Capital Contributions **(v)** Corporate bodies: Board of Director and Legal Representative; **(vi)** designate an auditor.

Corporations "S.A." must be created with at least five (5) shareholders, none of which may own ninety-five percent (95%) or more of the share capital at one time. The liability of shareholders is limited to the amount of their capital contributions, which is represented by shares.

The capital of the corporation is divided into shares of equal value, and is classified in three categories: **(i)** Authorized or stated capital which represents the total number of

subscribed shares plus the number of shares that are in reserve, if any. **(ii)** Subscribed capital, which represents the shares that have been issued to the shareholders, and may never exceed the corporation's authorized capital. Any issuance of shares over and above the authorized capital requires a prior increase in authorized capital by an amendment to the bylaws. **(iii)** Paid-in capital, which represents the shares paid by the shareholders. Upon incorporation of a corporation, at least 50% of the authorized capital must be subscribed for, and at least one-third of the value of the issued shares must be paid. The remainder must be paid within a one-year period. Further increases of authorized capital do not require subscription of any particular percentage of capital.

At the ordinary annual general meeting, the board of directors submits the financial statements of the corporation for the previous fiscal year to the shareholders for approval. Once they have approved the financial statements, the shareholders determine the allocation of the corporation's distributable profits, if any, for the preceding year. Ten percent (10%) of the corporation's net profits must be allocated to a legal reserve until such reserve reaches an amount equal to at least 50% of the subscribed capital of the corporation. The remainder of the net profits if any, is allocated as determined in the bylaws or by the shareholders and may be distributed as dividends. The corporation must distribute as dividend at least 50% of its annual profits, unless 78% of the shareholders vote otherwise. If the total amount of all the reserves of the corporation exceeds the corporation's outstanding capital, it must distribute 70% of its annual profits. No dividends shall be distributed if previous losses that affect the capital have

not been met. The dividend payment will be in cash, however, the dividend may be paid in the form of bonus shares of the same company, if so provided by decision of the general assembly by a vote of eighty percent of the shares represented.

*(ii) Company Limited by Shares (Sociedad en comandita por acciones)*

Under Colombian provisions, the establishment of a Company Limited by Shares will require the assignment of the following elements: **(i)** the purpose of the company which in Colombia is known as “objeto social;” **(ii)** the domicile of the company; **(iii)** The term of duration and the causes for termination; (iv) Capital Contributions **(v)** Corporate bodies: Legal Representative; **(vi)** designate an auditor.

This type of structure has two groups of partners: managers and limited partners. Managers are responsible for the administration of the entity, while the limited partners make capital Contributions to finance the needs of the entity. The managing partners are jointly responsible for the operations of the company, while the liability of limited partners is limited to the sum of its corporate contributions.

The capital, once again is divided into the same three categories mentioned above. The capital will be conformed with the contributions of the limited partners or with those of these joined simultaneously with those from the managing partners. Upon incorporation of a corporation, at least 50% of the authorized capital must be subscribed for, and at least one-third of the value of the issued shares must be paid. The remainder must be paid within a one-year period.

Regarding the profits and distribution of dividends the same process mentioned above applies. Specifically, corporate profits are distributed among the managing partners and limited liability partners in the manner stipulated in the contract. Where not specified, profits are distributed among the limited partners in proportion to their shares but the benefit of the managing partners must be met first.

*(iii) Limited Liability Company*

Under Colombian provisions, the establishment of a Limited Liability Company will require the assignment of the following elements: **(i)** the purpose of the company which in Colombia is known as “objeto social;” **(ii)** the domicile of the company; **(iii)** The term of duration and the causes for termination; (iv) Capital Contributions **(v)** Corporate bodies: Legal Representative and Board of Directors (not mandatory) **(vi)** designate an auditor, if the assets or income of the company exceed certain limits established by law (i.e., if the gross assets of the company at the end of the preceding year exceed or are equal to 5,000 minimum legal wages, or if its gross income in the preceding year exceeds or is equal to 3,000 minimum legal wages.)

The capital, once again is divided into the same three categories mentioned above. The capital of the company is divided into shares of equal value. The capital of the company must be entirely paid-in on incorporation and every time a capitalization takes place the corresponding article of the bylaws must be amended. Such amendment must be formalized by means of a public deed and the amount of capitalization must be paid upon the formalization of the decision. Partners are entitled to transfer their shares, but all other



partners have a statutory right of first refusal proportional to their existing participation, unless the bylaws provide otherwise. In other words, the partners shall have the preferential right to acquire the outstanding shares of the company on a first basis, whenever the other partners decide to sell its stake. As a general rule, the liability of the partners is limited to the amount of their capital contribution, however Colombian labor provisions establish that, the partners will be jointly liable for the employment obligations towards the company's employees; and tax laws provide that partners of a limited liability company are jointly liable for all the income tax obligations of the company.

Regarding the profits and distribution of dividends the same rules mentioned for Corporations will apply.

*(iv) Simplified Shareholding Company (S.A.S: Sociedad por Acciones Simplificadas):*

Under Colombian provisions, the establishment of a Simplified Shareholding Company will require the assignment of the following elements: **(i)** the purpose of the company which in Colombia is known as "objeto social;" **(ii)** the domicile of the company; **(iii)** The term of duration which in this case may be indefinite, and the causes for termination; **(iv)** Capital Contributions **(v)** Corporate bodies: at least a Legal Representative **(vi)** designate an auditor, only if the assets or income of the company exceed the limits established by law, which were mentioned above. In this case there is no minimum or maximum of shareholders required. This corporate structure foresees the possibility of having only one (1) shareholder. The liability of shareholders is

limited to the amount of their capital contributions, which is represented by shares.

The capital, once again is divided into the same three categories mentioned above. It will be divided into shares of equal value. In this particular case, there are no limits imposed on capital ratios in order for shareholders to subscribe and pay it. However, a deadline is imposed regarding the payment of subscribed shares, for which they must be fully payed in the term of two (2) years following the incorporation. This is an advantage offered by this type of corporation, as it provides a generous window for the payment of capital contributions.

Regarding the dividend distribution, in this type of corporations, freedom will be the general rule. It is permitted to establish in the bylaws of the corporation the rules that you consider should apply for dividend distributions. For example, you might stipulate that there will be no dividend distributions.

In these types of corporations there is no legal obligation to create legal reserves.

Finally, Colombian provisions have established that in the event of absence of regulation regarding any subject for this type of corporations, one must apply the regulations set forward for Corporations (Sociedad Anonima.)

If the subsidiary requires additional funding for the development of its operations in Colombian, it can always issue new shares, and/or receive funds from the parent company through an intercompany loan.

Every year, at the compulsory ordinary shareholders meeting, the board of directors or the legal representative, as applicable,





shall submit the financial statements of the subsidiary for the previous fiscal year for approval. Once approved, the shareholders determine the allocation of the corporation's distributable profits, if any, for the preceding year.

Without prejudice of the before, 10% of the corporation's net profits must be allocated to a legal reserve until such reserve reaches an amount equal to at least 50% of the subscribed capital of the corporation. The remainder of the net profits if any, is allocated as determined in the by-laws or by the shareholders, and thereafter it may be distributed as dividends.

The corporation must distribute as dividends at least 50% of its annual profits, unless 78% of the shareholders vote otherwise. If the total amount of all the reserves of the corporation exceeds the corporation's outstanding capital, it must distribute 70% of its annual profits. No dividends shall be distributed if previous losses that affect the capital have not been covered. The payment of dividends shall be in cash, except stated otherwise by the shareholders in the corresponding meeting. In the event of a sole shareholder the above stated majorities would not be relevant.

#### **4. Exchange regime compliance:**

All payments for capital contributions, for both the assigned capital of the branch and the subscribed and paid capital of the subsidiary, are considered a foreign direct investment and as such must be registered before the Central Bank under Form No. 4. In the event funds are

brought as debt they must also be registered before the Central Bank, but in this case under Forms No. 3 and 6.

The profits and dividends to be distributed and thereafter paid to the parent company also need to be registered before the Central Bank, under Form No. 4.

Additionally, every year before the 30th of June, both the branch and the subsidiary need to present Form No. 15 before the Central Bank informing of their current foreign investment status.

#### **5. Conclusions and Recommendations:**

To determine which mechanism is the best for doing business in Colombia, the first consideration that shall be made is if the activities that will be executed are permanent or not. If they are, the foreign company should evaluate whether a branch or a subsidiary best suits the company's purposes and structure.

The most common entities for commercial purposes are the Simplified Shareholding Company (S.A.S). This entity has a clear division between capital and responsibility, limiting, as a general rule, the liability of the investor to the amount of its participation.

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*This memorandum is for information purposes only and reflects the law on July 2017.*

*Under no account can it be considered as either a legal opinion or advice on how to proceed in particular cases or on how to assess them.*

*If you need any further information on the issues covered by this memorandum, please contact Mr. Daniel Garcia Piñeros (dgarcia@vgcd.co).*



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# INTERNATIONAL LAWYERS NETWORK



**PETERKA & PARTNERS**

**ESTABLISHING A BUSINESS ENTITY IN THE  
CZECH REPUBLIC**

**ILN CORPORATE GROUP**



## ESTABLISHING A BUSINESS ENTITY IN CZECH REPUBLIC

### 1. Types of business entities

Investors may choose from the following forms of corporate structure:

- Limited liability company
- Joint-stock company
- Limited liability partnership
- General partnership
- Cooperative
- Branch

#### 1.1 Limited liability company

A limited liability company (LLC) is the most frequent corporate structure used in the Czech Republic. An LLC is founded by a Memorandum of Association, if there is more than one founder, or a Foundation Deed, if there is a sole founder. No minimum registered capital is required by law for an LLC; the law only requires the minimum contribution of each shareholder in the amount of CZK 1. However, it is advisable to count on a reasonable starting amount for the registered capital for financing the launch of the business and thus avoid the application of the insolvency test from the very beginning.

Monetary or non-monetary (in-kind) contributions are allowed, namely real or personal property, certain intangible assets, and existing and documented due debts. The

value of in-kind contributions is subject to an official valuation. Generally, before applying for incorporating a company, the premium and at least 30 percent of each monetary contribution must be paid up. The outstanding amount must be paid up upon agreement between the shareholders within five years at the latest. Contributions in-kind must be paid up in full before the company is incorporated.

The company is owned by one or more individuals or corporations. Each shareholder holds an "ownership interest" which corresponds to a percentage of the total registered capital. As of 2014 an LLC with a sole shareholder can also be the sole shareholder or founder of another limited liability company.

The company itself is wholly liable for any breach of its obligations with all its assets. The liability of a shareholder for the company's obligations is limited to the unpaid amount of the shareholder's contribution. Consequently, shareholders in a limited liability company are not liable for the company's debts provided they have paid up their contributions in full. The "qualified" shareholders may exceptionally become liable for a company's debts by application of the rules on company groups, namely in insolvency, e.g., if they through their control or influence significantly affect the conduct of the company to the detriment of the company.

#### 1.2 Joint-stock company

A joint-stock company (JSC) is established by adopting By-laws. From 1 January 2014, there is no distinction between private and public JSCs. The minimum registered capital is CZK 2,000,000, or EUR 80,000 if the company chooses to keep accounts in EUR. There are no requirements for a minimum shareholder contribution. The company is owned by one or





more individuals or corporations.

Both monetary and non-monetary (in-kind) contributions are allowed, namely real or personal property, certain intangible assets, and existing and documented debts owed to the founders. The value of in-kind contributions is subject to an official valuation. Before incorporating a new JSC, the premium and at least 30 percent of the nominal value of shares must be paid up. The outstanding amount must be paid up in line with the By-laws within one year from the incorporation of the company at the latest.

The company itself is wholly liable for any breach of its obligations with all its assets. Shareholders in a joint-stock company are not liable for the company's debts. Certain "qualified" shareholders may exceptionally become liable for a company's debts by applying the rules related to company groups, namely in insolvency, e.g., if they through their control or influence significantly affect the conduct of the company to the detriment of the company.

Every joint stock company must have a website providing information about the company's name, registered seat, business identification number and incorporation data with the commercial register including the section and file, and publish various documents such as invitations to general meetings.

### **1.3 Limited liability partnership**

A limited liability partnership is a less frequently used corporate form. It must be founded by at least two individuals or companies, at least one of which ("limited partners") must contribute to the registered capital an amount set by the foundation document. Limited partners are liable for the company's debts up to the unpaid amount of their contribution. However, if the name of a

limited partner appears in the name of the company, the limited partner's liability for the company's debts is unlimited.

On the other hand, the other partners ("general partners") are not obliged to contribute to the registered capital. However, their personal liability for all the company's undertakings is unlimited.

### **1.4 General partnership**

A general partnership must also be founded by at least two individuals or companies. Registered capital is not created and all shareholders have an equal interest in the company, unless agreed otherwise in the partnership agreement. All partners are fully and personally liable for all the company's undertakings.

Beside monetary and non-monetary (in-kind) contributions, partners can also contribute to the company's capital by providing work or services if agreed in the foundation document.

### **1.5 Cooperative**

This legal form is not suited to the purposes of commercial undertakings. It is a traditional legal form frequently used for the ownership of private residential property.

### **1.6 Branch**

A branch, although it can be registered in the Czech Commercial Register, is not a legal entity. As it is not treated as a legal entity all legal acts taken by a branch are considered to be taken on behalf of its founder, which may be a foreign company. This may complicate the branch's operations and day-to-day business.

A branch is established upon the execution of a founding document known as the resolution of foundation. Its form depends on the requirements set up by the law governing the founder. Having at least officially certified signatures on the document is always





advisable. A branch must obtain the corresponding trade licenses or other permits necessary to do business, which correspond to the activities of the founder.

A branch must have a director who is an individual generally registered in the Commercial Register and who executes all legal acts relating to the maintenance of the branch on behalf of the founder. There is no requirement under Czech law regarding a branch's registered capital.

### **1.7 Entities under European law**

The European Company or Societas Europaea (SE) and European Economic Interest Grouping (EEIG) are also considered as business entities, which may operate in the Czech Republic.

## **2. Steps and timing to establish**

Generally, a company is established in two steps: 1. founding the company by adopting a foundation document, and 2. registering the company with the Commercial Register.

Founding a company does not mean it legally exists. In the period between its foundation and establishment the company does not have legal personality (it cannot acquire rights or obligations) and its statutory bodies do not yet exist. Company shareholders are only in the position of founders and not shareholders.

The Company's founders must authorise a person to administer the paid-up capital before incorporating the company. The administrator, often one of the founders or a bank, is obliged to take custody of the founders' contributions. In addition, they are obliged to provide a written statement on how much capital has been paid up, which must be attached to the application for registration in the Commercial Register. Upon establishing the company, these deposits become the property of the company, which may from that moment on freely dispose of them.

Before being established the company must obtain a business license (such as a trade or other license). The trade license is certified by an extract from the Trade Register held by the Trade Licensing Office. The company acquires the trade license, in the extent of the registered scope of business, from the date it was established.

A newly founded company must be registered with the regional Commercial Register before it can become a legal entity. Commercial Registers in the Czech Republic are kept by Regional Courts or the Municipal Court of Prague. Corporate information on existing companies such as business name, address, authorised representatives, registered capital and certain other information can be found in these registers accessible online.

In general, if an application to register a company in the Commercial Register fulfils all the requirements and all necessary documents are supplied, then the company will be registered within five working days of the application being filed. If the registration is done directly by a notary public, the company may be registered within one day.

## **1. Governance, regulation and ongoing maintenance**

### **3.1 Corporate governance**

Corporate governance is vested in the company's bodies and varies by the type and size of company.

For capital companies, the supreme body is always the general meeting of shareholders.

In a limited liability company, the obligatory company bodies are the general meeting and one or more executive directors or board of executive directors if allowed by the foundation documents; establishing a supervisory board is optional. Executive directors must act with due diligence and care and follow the principles and





resolutions passed by the company's general meeting in compliance with law and the Memorandum of Association or Foundation Deed. They may not disclose sensitive and confidential information to third parties. If they breach these obligations they are personally liable for all damage caused by the breach. They must also respect the non-competition clause envisaged by the Act on Business Corporations, which may be extended by the Memorandum of Association or Foundation Deed. Such ban can be however waived by all shareholders.

Joint-stock companies may choose between the dualistic model and the monistic model of corporate governance. The dualistic model requires the establishment of a board of directors and a supervisory board, whereas the monistic model means a board of administrators and statutory director. Business management is therefore executed either by a board of directors (in the dualistic model) or by a statutory director (in the monistic model), who must follow the same rules as executive directors in a limited liability company. In the monistic model, the supervisory board is substituted by a board of administrators, having mixed competences, which means that they combine the rights and duties of the supervisory board in the dualistic model on the one hand and also decide on the strategic orientation of the business management and supervise its execution by the statutory director on the other.

The supreme body of a partnership (both a limited liability partnership and a general partnership) is constituted of all partners, who are all equal and hold one vote each, unless stated otherwise in the partnership agreement. Business management is generally executed by either every partner in a general partnership, or every partner with unlimited personal liability in a limited liability partnership. Establishing a

supervisory board is voluntary.

Corporate governance rules are more detailed and rigid from 2014. Members of statutory bodies are obliged to perform their offices with the required loyalty, knowledge and care – with due diligence. A corrective to the strict rules of due diligence, called the business judgment rule, has been newly introduced. The rule states that a member of the statutory body is acting with due care and with necessary knowledge if he/she can in good faith reasonably assume when making his/her business decisions that he/she has acted in a well-informed manner and in the defensible business interests of the business corporation.

If a member of the statutory body breaches his/her obligations, he/she must return any profit obtained in connection with such breach or as the case may be provide indemnification of material and non-material damage in cash.

A new feature is the obligation of the member of the statutory body to return the profit obtained under a contract on the performance of the office and all other profits from the company received in the two years preceding a decision on bankruptcy, if he/she was aware or should and ought have to been aware of the fact that the business corporation was under imminent threat of bankruptcy, and contrary to acting with due diligence did not take all the necessary and reasonable steps to avert bankruptcy.

Under certain conditions a member of the statutory body can be excluded by the court from his/her office in any business corporation in the Czech Republic, and during this exclusion cannot be appointed to any such position.

If a statutory body member fails to settle damages to the business corporation caused by breach of obligation in the performance of his/her duties, he/she is liable for the debt of



the business corporation towards the creditor to the amount of non-settled damages if the creditor cannot satisfy its debt from the business corporation. Apart from liability for damage pursuant to the Insolvency Act when failing to submit an insolvency petition or for its late submission, a member of the statutory body might be under certain circumstances liable for fulfilling all the obligations of the business corporation if a legal decision on bankruptcy was issued.

Members of a company's bodies also have several other obligations, such as notification duties. For example, they must inform the supervising or supreme body if their interest conflicts with the company's interests, or if they intend to conclude a contract with the company.

Special attention is to be attached to the contract executed between the member of the statutory body and the company in order to avoid a situation where his/her performance of the office will be for free.

A company's problem-free existence is also ensured by what is known as an insolvency test which prohibits the company to pay out the profit if it caused its own bankruptcy.

### 3.2 Reporting requirements

An existing company must regularly publish in the Commercial Register, in particular the following documents:

- (i) annual reports,
- (ii) annual, extraordinary and consolidated financial statements (if not included in the annual report),
- (iii) proposal for distributing profit and its final form or settling losses, if not included in the ordinary financial statement,
- (iv) auditor's report certifying the financial statement, and
- (v) report on relations between related parties.

The annual reports and financial statements must be certified by an auditor before being published if the conditions of the accounting act are fulfilled.

Beneficial owners of corporations will be registered in a specific registry of "real owners" held by the Commercial Register from 2018. The newly created registry of real owners will not be publicly accessible.

### 1.3 Requirements for local shareholdings/directors

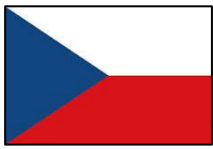
For shareholders, there are no requirements in respect of their nationality - they may be either Czech or a foreign individual or company.

As for the executive directors and members of various boards, they may be either a Czech or foreign individual or a company (except for a statutory director of a joint stock company or chairperson of the board of administrators, who must be an individual). Individuals must meet several requirements, for example, they must be 18 years of age, have a clean criminal record, consent with their registration, and fulfil other conditions imposed by law. Companies are in the performance of their function in a company's body represented by an authorised individual representative who must fulfil the abovementioned requirements as well.

Foreign nationals do not need a residence permit in the Czech Republic to be registered with the Commercial Register in a Czech company, though this may subsequently be required for non-EU nationals for living or working in the Czech Republic.

### 3.4 Protection of minority shareholders

In a JSC, minority shareholders are those who own at least 3 percent of the registered capital if the registered capital is more than CZK 100,000,000, 5 percent of registered capital if the registered capital is CZK 100,000,000 or less,



or at least 1 percent of the registered capital if the registered capital is CZK 500,000,000 or more. They are granted several minority rights, such as the right to ask the board of directors or the statutory director to summon an extraordinary general meeting to discuss issues proposed by them, or to have an issue proposed by them included in an ordinary general meeting, and the right to ask the supervisory board to examine the performance of the board of directors in matters determined by request.

They may, either through the board of directors or directly, require the payment of the outstanding part of the issue price from shareholders in default, or seek compensation for damage caused by members of the statutory body who have not acted with due diligence. They can also ask for the appointment of an expert to examine the report on relations between connected persons.

They also have several rights during transformation procedures and squeeze-outs.

The minority shareholders' position may also be strengthened during elections of company's bodies by "cumulative voting". For the purposes of the election, each shareholder's vote is multiplied by the number of elected members of the company's bodies. A shareholder may then give all his/her votes to a single candidate or divide the votes among more candidates which gives minority shareholders a greater possibility of influencing the body's composition.

Additionally, shareholders in LLCs have similar rights, though the percentage limit may differ, and in certain cases each LLC shareholder is entitled to act so.

## 2. Foreign investment, thin capitalisation, residency and material visa restrictions

### 4.1 Thin capitalisation rule

Thin capitalisation rules govern the maximum amount of tax deductible interest and other related financial costs (such as credit processing) paid on credits and loans in situations where they exceed the limits imposed by the Income Taxes Act (ITA). Thin capitalisation rules apply to credits (loans) involving related parties

### 4.2 Related-parties' transactions

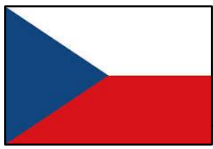
Transactions between related parties must comply with the arm's-length principle (that is, by applying fair market prices). Otherwise, the tax administrator may adjust the tax base of the party involved in the transaction by the difference between the price actually charged and the fair market price, and may assess additional tax and impose related penalties (including late payment interest on the additionally assessed tax). Certain exceptions to this rule relate to the interest on credits and loans.

According to the Guidelines of the Czech Ministry of Finance, OECD Transfer Pricing Guidelines apply in the Czech Republic.

### 4.3 Permanent establishment

Income derived through a permanent establishment of a foreign company located in the Czech Republic is regarded as Czech-source income.

A permanent establishment is defined as a "fixed place of business through which the business of an enterprise is wholly or partly carried on." A place of management, a branch, an office, a factory, a workshop and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources are always considered fixed places of business.



Providing services such as consultancy or management will create a permanent establishment if the services are rendered in the Czech Republic for more than six months in any consecutive 12-month period (unless a Double Taxation Treaty states otherwise). Similar rules generally apply to a construction site, an assembly line and other installation projects (but Double Taxation Treaties often impose specific conditions as far as construction sites are concerned).

A foreign company or individual who has a permanent establishment in the Czech Republic is obliged to register with the Czech Financial Authority and to file annual income tax returns.

#### **4.4 Withholding taxes**

Withholding tax is applied to certain types of income earned by Czech tax residents and to a number of Czech-sourced types of income earned by Czech tax non-residents. The tax rate is 15 percent. However, the withholding tax rate applicable to the Czech sourced income of Czech tax non-residents as stipulated by the ITA may be reduced by the relevant Double Taxation Treaty. In case of income from Czech sources paid to taxpayers who are tax residents from countries that are not EU and EEA members, did not conclude a DDT with the Czech Republic, and did not conclude a bilateral agreement on exchange of information concerning income tax with the Czech Republic or a similar agreement on a multi-national basis, the withholding tax rate is increased to 35 percent.

Tax payers and EU residents can file an income tax return in which related expenses can be applied and withholding tax is considered an advance payment. However, this is only possible for certain types of income, namely royalties, interest, income from contractual penalties and remuneration for members of

statutory bodies.

No withholding tax is applied to dividends if the payer and recipient qualify as a subsidiary and a parent company within the meaning of the EU Parent Subsidiary Directive (for further details see Harmonisation with EU Tax Legislation below) and in certain cases of interest payments under the conditions stipulated by the ITA.

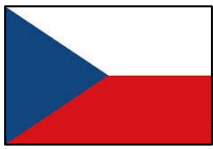
#### **4.5 Avoidance of double taxation**

To date the Czech Republic has concluded 87 Double Taxation Treaties which closely follow the wording of the OECD Model Tax Convention. Double Taxation Treaties, among other things, can reduce the withholding tax rate applicable to Czech tax non-residents' income from Czech sources and stipulate the method for the avoidance of double taxation to be used with respect to particular types of income. The Double Taxation Treaties usually stipulate the application of either the exemption (exemption with progression) or simple credit methods. If no Double Taxation Treaty has been concluded between the Czech Republic and the respective country, the Czech sourced income of foreign tax residents will be subject to Czech taxation under Czech tax law.

#### **4.6 Harmonisation with EU tax legislation**

In relation to the accession of the Czech Republic to the EU on 1 May 2004 EU Directives concerning direct taxation (income taxation) were incorporated into the ITA.

Based on the so-called Parent Subsidiary Directive (and related amending Directives), dividends and other profit share distributions between Czech and EU companies which meet the definition of a parent company and its subsidiary are not subject to corporate income tax. To qualify as parent and subsidiary companies, companies must fulfil the following conditions:



- the companies must take a legal form listed in the respective EU Directives,
- the minimum capital holding in the subsidiary is 10 percent and is held by the parent company for an uninterrupted period of at least 12 months (can be fulfilled subsequently),
- the companies must be EU member state tax residents,
- the companies must be subject to corporate income tax as stated in the respective EU Directives.

Similar conditions also apply if dividends are paid by a Czech subsidiary to its mother company if it is a tax resident of Switzerland, Norway, Iceland or Lichtenstein.

#### **4.7 Further corporate tax exemptions**

Tax exemptions for dividends and other profit share distributions have been extended to profit share distributions paid to a Czech tax resident (and also to a Czech permanent establishment of a tax resident of another EU member state) by a subsidiary which is a tax resident of a state which has concluded a Double Taxation Treaty with the Czech Republic. Besides conditions like those already stipulated for the tax exemption of share distributions paid between companies within the EU, subsidiaries from third states must also meet further conditions, such as being subject to a minimum 12 percent tax rate in their home country.

Under similar conditions as for shares in profit, the tax exemption further applies to the income of a parent company, being a beneficial owner, which is a tax resident of the Czech Republic or a Czech permanent establishment of a Czech tax non-resident from another EU member state, from the sale of a share in the subsidiary (which is a tax resident of the EU or a third state which has concluded a Double Taxation Treaty with the Czech Republic).

#### **4.8 Residency and visas**

The majority of Czech immigration regulations is contained in the Act on the Residence of Aliens in the Czech Republic No. 326/1999 Coll., as amended, and Regulation (EC) No. 810/2009 of the European Parliament and of the Council of 13 July 2009, establishing a Community Code on Visas (Visa Code). The basic rules regarding EU and non-EU nationals are as follows:

##### **4.8.1 Residency of EU nationals**

All EU nationals who work or live in the Czech Republic enjoy equal treatment as do Czech nationals. To commence work or to take up a position of a statutory body member with a Czech company, neither a work permit nor a visa is required for an EU member state national. If an EU national is employed with a Czech employer only a notification form must be filed and passed over for statistical purposes to the local labour office. An EU member state national does not need a temporary or permanent residence permit to reside in the Czech Republic. An EU member state national is only obliged to register with the Local Office of the Foreign Police if they expect to stay in the Czech Republic longer than 30 days.

A similar regime applies to family members of EU nationals who reside in the Czech Republic with the EU national. The family members of EU nationals, who intend to reside in the Czech Republic with the EU national for a period longer than three months, are however obliged to apply for a temporary residence permit within three months of entering the Czech Republic.

##### **4.8.2 Third country nationals**

Council Regulation No. 539/2001 lists the third countries whose nationals must be in possession of visas when crossing external borders and those whose nationals are





exempt from that requirement.

Third-country nationals not subject to the visa obligation may stay in Schengen states for up to 90 days within a 180-day period from their first entry. The duration of individual stays in different Schengen states cumulates.

Third-country nationals subject to the visa obligation may enter and stay in the Schengen area only on the basis of a uniform visa for stays up to 90 days (short-term Schengen visa) which allows the holder to stay on the Schengen territory for the period stipulated in the visa, which does not exceed 90 days within a 180-day period. The 90-day period starts from the date of first entry into Schengen territory.

Those who have already stayed in Schengen states for 90 days within a 180-day period must leave the Schengen area unless they are in possession of a Schengen visa with limited territorial validity or a national residency title issued by a Schengen member state, such as a long-term visa or a long-term residence permit.

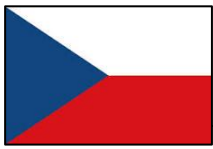
Long term visas are granted for the specific period of the stay corresponding to the purpose of the stay and the validity of the submitted documents, but have a maximum duration of one year. Generally, if a validity of a long-term visa is shorter than one year and if the purpose of the stay still applies, the long-term visa can be extended repeatedly, but no more than for one year. The application to extend the long-term visa must be submitted at the earliest 90 days and at the latest before the long-term visa expires.

Third-country nationals who hold long term visas are entitled to file an application for a long-term residence permit if they intend to reside in the Czech Republic for a period longer than one year and if the purpose of

stay is the same as indicated on their long-term visa. A long-term residence permit can be continuously extended. The application for a long-term residence permit and the application to extend the long-term residence permit must be submitted at the earliest 120 days before the long-term visa or the long-term residence permit expires and at the latest before the long-term visa or the long-term residence permit expires.

Applicants can apply for a visa at the Czech embassy in their country of origin (for certain third-countries the application can be filed at any Czech embassy) and for a long-term residence permit, with certain exceptions, at the relevant department of the Ministry of the Interior. The applications to have a long-term visa or a long-term residence permit extended can be submitted at the relevant department of the Ministry of Interior. The application should be decided within 15-30 days (short term Schengen visa), 90 days (or 120 days in complicated cases) for a long-term visa, or 60 days for a general long-term residence permit.

With certain exceptions, long term visas and long-term residence permits for employment purposes are no longer granted. All non-EU nationals applying for work in the Czech Republic and intending to reside in the Czech Republic for more than 3 months are required to obtain an employment card, a blue card or an intra-corporate transferee card. These are specific residential titles allowing a non-EU national simultaneously to reside and work in the Czech Republic. The employment card is a general residence title for employment purposes whereas the blue card is intended for highly skilled employees, as a university education and relatively high salary are required and the intra-corporate transferee card is intended for selected employees, namely managers, specialists and trainee



employees who reside outside the territory of the European Union and who are subject to an intra-corporate transfer to the Czech Republic. With certain exceptions, applications for an employment card, a blue card or an intra-corporate transferee card must be submitted, in person, by an applicant at a Czech embassy.

In certain cases, such as when a non-EU national intends to reside in the Czech Republic for fewer than 3 months, he/she is posted by his/her foreign employer to perform work in the Czech Republic, or he/she is employed as a seasonal worker, a work permit is required in addition to a Schengen visa (residence up to 3 months); or a long-term visa (a seasonal worker whose residence exceeds 3 months) or an employment card (posting of an employee, other cases) is required. In these cases, a non-EU national applies for a work permit and subsequently for an appropriate residence

permit. Applications for a work permit are submitted by the applicant, or by an attorney authorised under a power of attorney, to the relevant Labour Office, generally before their arrival in the Czech Republic. A work permit is usually issued within 30-60 days of the application being submitted. Under specific conditions, such as when a non-EU national has completed his/her education in the Czech Republic, the obligation to obtain a work permit may be avoided.

\* \* \*

*This memorandum is for information purposes only and reflects the law on 15 September 2017.*

*Under no account can it be considered as either a legal opinion or advice on how to proceed in particular cases or on how to assess them. If you need any further information on the issues covered by this memorandum, please contact Ms Adela Krbcova ([krbcova@peterkapartners.cz](mailto:krbcova@peterkapartners.cz)).*

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*The firm provides legal services to the multinational companies active in the region as well as leading local groups, providing them with complex legal solutions with an exceptional commercial value.*



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# INTERNATIONAL LAWYERS NETWORK



FLADGATE LLP

ESTABLISHING A BUSINESS ENTITY IN ENGLAND

ILN CORPORATE GROUP



## ESTABLISHING A BUSINESS ENTITY IN ENGLAND

### *Foreword*

The attractiveness of the United Kingdom (UK) as a business location is unabated. There are many advantages to doing business in the UK. Investors can draw on a skilled workforce and access a large market; costs of labour and production are lower compared to many other western European countries; investors benefit from a business friendly environment as well as a high degree of legal certainty and political stability; its capital, London, is a world leading commercial and financial centre.

These features make the UK an attractive place to do business, not just for large corporations but also for small and medium-sized businesses. Many foreign companies use the UK as a first stepping stone for expansion into Europe.

Investing in a foreign country requires awareness of the pitfalls, and prospective investors will have many questions. It is important to have advisers who are familiar with both the legal and the practical issues.

This guide offers an overview of legal aspects of conducting business in England and Wales. It is meant as an introduction to our market place and does not offer specific legal advice.

Fladgate LLP accepts no liability for anything contained in this guide or for any reader who relies on its content. Before concrete actions or decisions are taken, you should seek specific legal advice. We remain at your disposal in relation to questions regarding this guide and look forward to assisting you.

This guide describes the law in force in England and Wales as at 1 August 2017, but please bear in mind that statutes, regulations and rules are subject to change.





The United Kingdom (UK) comprises England, Wales, Scotland, and Northern Ireland. Great Britain includes these countries, but not Northern Ireland.

Within the UK there are three distinct legal jurisdictions, namely England and Wales, Scotland, and Northern Ireland. Each has its own laws, courts, and lawyers. In most commercial areas, the law is the same or very similar e.g. company law and tax, but in some, such as, real property, it is very different. This guide is about England and Wales, which we generally refer to just as England.

The UK is a member of the European Union (EU). While the country has on 23 June 2016 voted to leave the EU in a referendum, it is for the moment unclear what the timing and terms of this “Brexit” will be. For the time being, the UK continues to be an EU member and EU laws and regulations as well as their implementation in domestic law continue to apply in full.

Setting up a business in England is quite straightforward. A foreign investor is in exactly the same position as his British counterpart. Essentially, the legal basis for establishing an incorporated business is the Companies Act 2006 (as amended).

## 1. Types of business entity

There are various ways for an overseas investor or entrepreneur to set up a business in England:

- by forming a private limited company (Limited) or a public limited company (Pic);
- by establishing a branch (a so-called “UK establishment”);
- by forming a partnership (limited partnership, limited liability partnership, general partnership);
- by entering into a joint venture; or
- by buying or acquiring an interest in a company.

In addition to the above possibilities, commercial

agents can be engaged or distributors appointed.

The structure chosen for establishing a business in England is likely to be influenced by taxation considerations. This guide does not address these issues, on which advice should be sought.

The decision as to which structure to use depends on a whole range of taxation, company law and other legal considerations. Fladgate LLP has a wealth of experience in these matters. We will be happy to give any advice which may be required in connection with establishing an English operation and in dealing with the necessary legal procedures.

This section sets out the requirements for incorporating an English private limited company as the wholly owned subsidiary of a foreign company. The public limited company form is chosen only for a small number of companies. Formation of a public limited company (a legal form mainly used for companies quoted on the stock exchange) will not be considered further in this guide. Fladgate LLP will, however, be pleased to assist with the formation or buying of such a company, if required.

### 1.1 Formation of a company

There are two ways of doing this: either by forming a new company or by buying a company that has already been formed, known as a shelf company. Either way, the process is very quick.

#### *Articles of association*

A company must have articles of association, which represent the constitution of the company. Companies House (the UK central commercial register) has produced model articles for use where newly formed companies have not drawn up their own articles of association.

#### *Share capital*

An English private limited company must have a share capital, but no minimum contribution is





laid down by law so that the nominal capital can be as little as £0.01 and is frequently just £1. The capital can be in any currency, for example euros (€), or it may be made up of various currencies.

Companies formed since the Companies Act 2006 are not required to state any amount of capital in the articles of association. All they must do, when applying to register the company with Companies House, is to notify the initial capital and to send in a fresh notification if new shares are issued.

Furthermore, there is no tax payable by reference to the level of capitalisation. It is possible to incorporate a subsidiary with a substantial capitalisation, to enable it to stand alone without the support of parent guarantees, and to avoid the need for subsequent share issues, without incurring any tax liability.

There need only be one shareholder, which may be a company and which does not need to be UK resident or incorporated in England.

#### *Company name*

If the subsidiary is a private limited company, the corporate name must end with the word “Limited” or the abbreviation “Ltd”, unless a special exemption has been granted. However, this exemption is only applicable for non-commercial purposes.

The name must not be the same as any existing corporate name. There are also restrictions on names likely to mislead or cause offence, criminal names, names that may suggest a connection with the government or a local authority, and names containing certain specified “sensitive” words, such as Insurance or Trust.

We can run a check of your chosen name for you, to ensure that it is available and capable of being approved.

#### *Directors and company secretary*

The company must have at least one director who is an individual. There are very few restrictions on the choice of directors, apart from a minimum age of 16. Persons who have, for example, been involved in a business insolvency or who have a previous conviction may be debarred from holding directorships.

Directors can be of any nationality.

There is no legal obligation for private limited companies to appoint a company secretary, although this is still allowed. The company secretary keeps the company’s records and ensures that the company complies with the main provisions of company law. Where companies have foreign owners, it may be advisable to appoint a company secretary in England, and there are agents who offer this service.

#### *Registered office*

The company must have a registered office in England or Wales for delivery of official documents and correspondence, for instance from Companies House or HM Revenue & Customs. This address does not have to be the same as the business address.

#### *Accounting reference period*

The accounting reference period is normally a period of 12 months. It is calculated from the date of incorporation to the last day in the calendar month, one year from the date of incorporation (the accounting reference date). This can be changed, subject to certain provisos. Accounting reference periods commonly selected are either the calendar year or the year from 1 April to 31 March, which is slightly in advance of the UK tax year.

#### *Special approval requirements for an English limited company*

It should be noted that running the business of a subsidiary or branch in England may require



certain trading licences or other approvals. For example, the formation and the operating of a financial services business will require certain authorisations and different requirements. However, few businesses require approval. Fladgate LLP can advise you if authorisation requirements apply to your business.

**1.2 Establishing and operating a branch (UK establishment)**

The concept of a branch should be regarded as an extension of the parent company. An authorised person appointed to run the branch can enter into transactions with third parties in the parent company’s name. The branch may be of the foreign company itself or one of its subsidiaries. In any case, under the English system, the branch is not a legal entity in its own right and therefore the parent company remains fully liable.

No approvals are required to set up a UK establishment, but there are some registration requirements relating both to the foreign company and the branch that must be completed within one month from opening the UK establishment.

If smaller scale activities are planned, then an overseas company can consider simply registering a place of business. The distinction between a place of business and a branch is a fluid one. The former will not normally be authorised to conduct the business of the foreign company in England. Examples of a mere “place of business” are a warehouse and a marketing office.

**1.3 Limited Liability Partnership**

It is possible to form a limited liability partnership (LLP) in England. LLPs have the advantage of being taxed as a partnership but at the same time having limited liability. The result is something of a hybrid.

LLPs are particularly popular with professional service providers (e.g. lawyers and accountants). Whereas the limited company is already quite user-friendly by international standards, the LLP is even more flexible from a company law and internal structure point of view. However, it is not yet widely used as a legal form for new business start-ups outside these areas.

**1.4 Partnerships and Limited Partnerships**

Foreigners can also establish partnerships (general partnerships) in England, although the partners will potentially have unlimited liability.

Another possibility is to form a limited partnership (LP). In contrast to the LLP (see above), the LP has only a limited legal personality of its own. Its partners, provided they are not involved in managing the LP, will be protected by limited liability, but it must have at least one general partner, whose liability is unlimited. The general partner can be a limited company. LPs are especially preferred by investment funds. They are neutral for tax purposes and therefore they are not taxed separately.

**1.5 Using commercial agents**

As an alternative to forming a limited company or establishing a branch, a foreign company may also decide to work in the UK market through a commercial agent.

Relations between a commercial agent and his principal are governed by the Commercial Agents Regulations 1993. These regulations contain a series of mandatory provisions designed to give the commercial agent greater protection. It should be emphasised that compensation is nearly always payable if the contract is terminated. If agreed in the agency contract, an indemnity is payable. If nothing is agreed in the agency contract, compensation is payable based on the notional value of the agency at the date of the termination.



Fladgate LLP is one of the leading law firms in the area of commercial agency law, and advises and represents both agents and principals.

### 1.6 Joint venture

A foreign company can also form a joint venture with a UK or another foreign corporation or an individual. Most commonly, the vehicle used will be a private limited company, but it may simply be a contractual joint venture.

### 1.7 Buying or acquiring an interest in a company

As an alternative to forming a new company, the foreign business can buy an established English company or purchase shares in it. This is certainly the quickest way of gaining a business foothold in the U.K.

## 2. Maintenance and reporting

### 2.1 Company

#### *Public filing requirements*

The company will be subject to English company law relating to the filing of information that is available for public inspection with the Registrar of Companies at Companies House. Failure to comply with these requirements is a criminal offence.

#### *Annual accounts and reports*

The company must keep proper accounting records which are sufficient to show and explain its transactions, to disclose with reasonable accuracy the company's current financial position and to enable the directors to ensure that the balance sheet and profit and loss account comply with the statutory requirements.

The accounts must be prepared in accordance with a detailed format and contents specified by the Companies Act 2006.

In general, all accounts filed with the Registrar of Companies must be audited, although there are exemptions available to small companies.

#### *Auditors*

Auditors to a company must be UK-qualified or have UK-recognised overseas qualifications.

A company is entirely exempt from the audit requirement if it qualifies as a "small company". At least two of the following conditions must be met: annual turnover must be £10,200,000 or less; the balance sheet total must be £5,100,000 or less; or the average numbers of employees must be 50 or fewer.

#### *Registers*

In addition to the filing of the information referred to above with the Registrar of Companies, English company law requires the company itself to maintain a number of registers, such as a register of members (shareholders/stockholders).

Private companies have the option, as from June 2016, of keeping certain information on the public register at Companies House, instead of separately maintaining their own registers. This applies to the PSC register (see below) as well as other statutory registers such as the register of members.

#### *Beneficial owners register*

UK companies and LLPs are required, as from April 2016, to keep a register of people with significant control (**PSC register**), recording details of anyone who has significant control over the company. For these purposes, significant control includes holding (directly or indirectly) 25% or more of the shares or voting rights in the company, having the right (again, directly or indirectly) to appoint or remove a majority of the board of directors, or otherwise having the right to exercise "significant influence or control" over the company.



### *Confirmation statement*

Except in relation to narrowly defined exceptions (such as share issues or changes of directors), there is no duty to update the Registrar of Companies of changes to the circumstances of the company as and when they happen. The company must, however, deliver a confirmation statement to the Registrar of Companies each year. The statement is made by the company and confirms that the information held by Companies House (e.g. in relation to its share capital, shareholders, officers, and other corporate information) remains accurate. If the information held by the Registrar of Companies is out of date then the company must file the information needed to update its records before or at the same time as it delivers the confirmation statement. Failure to comply with this requirement is a criminal offence.

### *Registration of charges*

Particulars of most charges or other security created by the company and any changes to them must be notified to the Registrar of Companies within 21 days of their creation or change.

### *Other matters requiring registration*

The Registrar of Companies must also be notified within 14 days of any changes in the details and particulars of the company's directors, secretary and registered office and, if a new director or secretary is appointed, his written consent to act must accompany the notification.

Many resolutions passed by the company, for example, any resolution amending its articles of association, also must be filed with the Registrar.

### *Company name and stationery*

The company's name, place of registration, registered number, and registered office,

including the word "Limited" or "Pie" must be set out legibly on all its business letters, notices, cheques, bills of exchange, letters of credit and other financial instruments and on all order forms, invoices, and receipts etc. The company's VAT number should be shown on all accounting forms such as invoices, orders, and estimates.

The company must display its name at each place of business in easily legible characters and in a conspicuous position.

## **2.2 Branch**

### *Registration of security*

Particulars of most charges or other security created over property or assets in the UK owned by an overseas company with a branch in the UK and any change to them must be notified to the Registrar of Companies within 21 days after their creation or change. Existing charges relating to such property will have to be registered when a branch is set up or charged assets are brought into the UK.

### *Accounts*

Once a branch has been opened in the UK, the overseas company is subject to continuing obligations to make disclosures of its accounting documents.

If the overseas company is required by its local law to prepare, have audited, and disclose accounts, the overseas company must deliver to the Registrar of Companies copies of all the accounting documents prepared, audited, and disclosed in accordance with its local law within three months from the date on which the accounting documents are first disclosed as required by the company's local law. English translations, where appropriate, are required.

If the overseas company is not required to prepare, have audited, and publicly disclose accounts, the overseas company is still required to file accounts as if the overseas company



were subject to UK law, subject to extensive modifications in that the accounts do not need to be audited, directors' reports are not required and details of directors' remuneration and loans do not have to be disclosed (as would be the case if the company were incorporated in the UK). Such accounts generally must be filed within 13 months of the end of the relevant financial period.

These rules are slightly modified in relation to branches of credit and financial institutions and banks.

#### *Company name and stationery*

An overseas company which carries on business in the UK is required to state its name and country of incorporation and, if it has limited liability, notice of that fact, on all business letters, notices, and official publications and to exhibit such information at every place where it carries on business in the UK.

#### *Notification of changes*

The Registrar of Companies must be notified of any changes to the registered particulars of the branch. This must be done within 21 days of the event, if the change relates to the person(s) authorised to accept service, or otherwise within 21 days of the date on which notice of the event could have been received in the UK, if dispatched with due diligence.

### **2.3 LLPs, LPs, and general partnerships**

LLPs are registered by Companies House and have similar reporting obligations to companies, and the forms used are typically variations of the forms prescribed for company use. The main and probably most important distinction is that while the articles of association of a company must be placed on the public file at Companies House, the members' agreement for an LLP is a private document.

LPs are also registered by Companies House but only have certain limited reporting obligations.

General partnerships are not registered by Companies House and have no reporting obligations.

### **3. Competition rules and restrictions**

#### *Behavioural rules*

Failure to comply with UK or EU competition law can have serious consequences for businesses operating in the UK. Since 1 April 2014, the Competition and Markets Authority (**CMA**) has assumed primary responsibility for the enforcement of the competition law rules in the UK and the pooling of resources into a single authority has coincided with more robust and active enforcement of the competition law rules.

In the UK, two sets of competition law rules apply in parallel. Anti-competitive behaviour which may affect trade within the UK is prohibited by Chapters I and II of the Competition Act 1998 and the Enterprise Act 2002. Where the impact of the anti-competitive behaviour extends beyond the UK and affects trade between EU Member States, it is prohibited by Articles 101 and 102 of the EU Treaty (which mirror the Chapter I and Chapter II prohibitions).

UK and EU competition law prohibit two main types of anti-competitive activity

- restrictive agreements or arrangements between enterprises which have an appreciable impact on competition (as set out under the Chapter I/Article prohibitions); and
- conduct which amounts to an abuse of a dominant market position (as set out under the Chapter II/Article 102 prohibitions).

The penalties for breaching these rules are significant. Parties can be liable for fines of up to 10% of global turnover, whilst provisions in agreements that breach Chapter I or Article 101 are void and unenforceable. Companies can also be subject to actions for damages from competitors and/or customers who are able to demonstrate that they have suffered loss(es) as a





consequence of the competition law breach. The most serious infringements of Chapter I can result in individuals being subject to criminal sanctions and directors facing disqualification orders.

As well as the CMA, various “sectoral” regulators have powers to apply the competition law rules in particular industries, for example Ofcom within the communications sector. These authorities have significant powers to investigate suspected anti-competitive activity, including entering and searching business and private premises. Competition law cases are also increasingly being prosecuted through the UK courts and via the specialist Competition Appeal Tribunal (**CAT**).

#### *Merger control*

Mergers in the UK are governed by the Enterprise Act 2002. A qualifying transaction for UK merger control purposes is one which involves (at least) the acquisition of material influence by one enterprise over another and where either:

- the UK turnover of the target enterprise is more than £70 million; or
- the merging parties’ combined share of supply of goods/services of a particular description in the UK/a substantial part of the UK is 25% or more.

The UK has a “voluntary” system of merger control which means that parties to a qualifying merger are not under an obligation to notify and seek approval from the CMA prior to completing their transaction. However, where they fail to do so, the parties run the risk that the CMA decides to intervene and carry out an investigation into the competitive impact of the deal, which it is entitled to do at any point up to 4 months from completion or from when it first becomes aware of the transaction (whichever is later). In those circumstances, the CMA has powers to impose “hold separate” obligations on the parties forcing them to keep the merging businesses running as separate entities pending completion of any investigation. Ultimately, if the CMA decides

there are competition issues, it can demand concessions from the parties or even force the buyer to sell the acquired firm/assets.

Larger transactions may fall under the jurisdiction of the EU Commission under the EU Merger Control Regulation. These require compulsory notification and therefore that completion is suspended pending competition clearance.

Given the implications, it is advisable always to obtain specialist competition law input at an early stage in relation to any proposed transaction.

#### **4. Local shareholding/directors**

There are no such requirements.

#### **5. Minority shareholders’ rights and protections**

Members of companies and LLPs have protection against being “unfairly prejudiced” and can bring action in the courts to seek relief for this. In the case of LLPs, this can be excluded by written agreement (typically, within the LLP members’ agreement).

#### **6. Barriers to entry**

England, and indeed the UK as a whole, is relatively lightly regulated. Significant barriers to entry are only likely to apply in the case of business areas that are themselves regulated, such as banking, financial services, pharmaceuticals, and gaming.

Regulation is typically intended for consumer protection.

We will be happy to advise further on whether a particular sector is subject to regulation.

#### **7. Capitalisation**

Certain regulated sectors, particularly banking and financial services, have a requirement for capital linked to their business and its potential liabilities.

#### **8. Special business or investment visa issues**

Generally, citizens of European Economic Area countries (the European Union plus Iceland,



Liechtenstein, Norway, and Switzerland) have the right to live and work in the UK. There are restrictions affecting some countries, and advice should be sought before a commitment is made.

There are restrictions on citizens of other countries living and working in the UK, and specific advice should be sought prior to travel. There is a visa category available for those wishing to invest £200,000 into a new or existing business in the UK (and be involved in the running of that business). There is also an investor visa category for those wishing to invest a minimum of £2 million in the UK.

## 9. Restrictions on remitting funds out of the jurisdiction

### 9.1 Distribution of profits

#### *Subsidiaries*

A withholding tax on dividends does not exist in the UK.

Dividends received by non-residents will be taxable in accordance with the rules in their country of residence, but will not be taxable in the UK. An overseas company may be entitled to a credit for UK taxation borne by an English company in which it is a shareholder on profits distributed to it.

#### *Branches*

A UK branch of an overseas company will pay UK corporation tax on its profits. Since a branch is not treated, except for limited purposes, as a separate legal entity from the foreign corporation, the branch will not pay a “dividend” to the parent. The overseas company may be entitled to relief in its own jurisdiction for tax paid in the UK.

### 9.2 Transfer pricing

Anti-avoidance legislation exists to prevent arrangements under which the UK operation charges artificially low prices to, or is charged artificially high prices by, foreign affiliates. The

transfer pricing regime is in line with OECD guidelines and will broadly apply where the actual provisions in a transaction differ from the provisions which would have been made at arm’s length between independent enterprises as a result of which a potential advantage in relation to UK taxation is conferred. Transactions for this purpose are widely defined and include interest payments. This could lead to interest payments of thinly capitalised subsidiaries being disallowed a tax deduction. Careful record-keeping may be required to provide evidence on which pricing is based.

### *Our firm*

*Fladgate LLP is one of central London’s leading law firms, providing legal advice of the highest quality in English law for a diverse portfolio of clients. The firm’s client base has a strong commercial focus, comprising multinationals, listed companies, banks, and lenders.*

*Fundamental to the firm’s philosophy is the belief that clients want a high standard of professional service and a high degree of personal attention, but at competitive rates. At Fladgate LLP, this is illustrated by the ability to have immediate access to a partner and by the firm’s readiness to take the initiative in offering advice. Our fee earners have an in-depth knowledge of the industries in which they practise and extensive experience of delivering advice that is both commercial and technically expert.*

*In addition to advising a substantial UK-based client base, the firm provides a proactive and efficient service for clients with international business through specialist groups which serve continental Europe (with an emphasis on the Germanic countries and France), Israel, India, the US, the Gulf region, and the Far East. Operating from London and comprising multilingual and multi-qualified lawyers, these groups facilitate cross-border activities for a diverse range of companies. We can advise our clients in many languages, including English, German, Hebrew, French, Portuguese, Romanian, Russian, Spanish, Hindi, Gujarati, and Urdu.*

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# INTERNATIONAL LAWYERS NETWORK



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**ESTABLISHING A BUSINESS ENTITY IN ESTONIA**

**ILN CORPORATE GROUP**

## ESTABLISHING A BUSINESS ENTITY IN ESTONIA

### 1. Types of business entities

The most common types of companies in Estonia are the public limited liability company ("AS") and the private limited liability company ("OÜ"). The OÜ may be compared to a closed corporation: its shares are not publicly traded and there are usually rather few shareholders. The shares of an AS, in contrast, are always in book-entry form and more easily transferable.

The main reason most businesses opt for the OÜ form is that the minimum share capital requirement is EUR 2,500 (does not have to be paid upon registration by an individual person), whereas for the AS it is EUR 25,000. In addition, OÜ form has more simple management structure (one level with sole management board member) and it does not have automatic auditing obligation.

A shareholder may be liable for damage caused to the company, another shareholder or third persons by carelessness, gross negligence, or an intentional act. A shareholder is not liable for any damage caused if the shareholder did not participate in the adoption of the respective resolution or if the shareholder voted against the resolution. If the shareholders adopt a resolution on a matter that would normally be in the capacity of the management or supervisory boards, they may be liable as if they were members of the management or supervisory board.

An AS must always have an auditor to audit its annual reports. Whether an OÜ must have an auditor depends on its turnover, amount of assets and number of employees (there are two different standards of examination: an audit and review; to be subject to the review requirement, one of the following criteria must be met: the total value of assets EUR 2.4 million, turnover exceeds EUR 4.8 million, or

more than 72 employees; or two of the following criteria must be met: value of assets EUR 0.8 million, turnover exceeds EUR 1.6 million, and more than 24 employees; to be subject to the audit requirement, there are higher thresholds); an examination by an auditor may also be necessary because such a requirement has been stipulated in the articles of association.

### 2. Steps and Timing to Establish

It is possible to acquire an existing company, but to establish a new company, the following steps must be taken:

- concluding a notarised memorandum of association to which articles of association are annexed;
- opening a bank account in an Estonian credit institution, into which monetary contributions are paid. Generally, founders are required to go to the bank in person for identification purposes. If the articles of association so prescribe, non-monetary contributions may also be used. The valuation of non-monetary contributions must be audited in case of an AS and, in certain instances, in the case of an OÜ;
- registering the shares in the Central Register of Securities (not required in case of an OÜ, but optional);
- submitting documents to the Commercial Register.

To establish a branch, a notarised application must be filed by the director of the branch. Additional documents to be filed with the application include a certificate concerning the existence of the company in its home country, a document certifying the authority of the director (e.g. a PoA or a board resolution) and a



copy of the articles of association of the company.

Companies and branches are usually registered within five business days from submission of their documents to the Commercial Register. Please note that documents regarding a foreign company establishing a branch or a subsidiary must be officially certified and in most cases apostilled or legalized.

Latvian, Finnish, Belgian, Lithuanian, and Estonian citizens may establish a company electronically through the Company Registration Portal ("CReP"). It is not possible to establish a branch electronically. Electronic establishment allows utilization of an expedited procedure, meaning that the Commercial Register will process the petition during the next business day after receiving the application. There are no notary fees, but the state duty is a bit higher: EUR 190 (otherwise EUR 145). Only monetary contributions may be made in the fast-track procedure. An Estonian credit institution may open a bank account via CReP in the name of the company being founded only if the monetary contribution is made through a bank account opened in another Member State of the European Economic Area (EEA) and the cash stands on the account until the company has been entered in the Commercial Register.

### **3. Governance, Regulation and Ongoing Maintenance**

#### **3.1 Corporate Governance**

AS shall have a two-tiered management system: the management board and the supervisory board. OÜ has no supervisory board by default, but may decide to form one.

The management board is the legal representative of the company and the head of everyday business. The company may be

represented individually by each member of its management board unless the articles of association prescribe that the company may only be represented jointly by members of the management board.

The supervisory board advises and supervises the management board and is responsible for the strategic management of the company.

Members of management and supervisory boards must be natural persons with active legal capacity. They are required to perform their obligations with the diligence normally expected from a member of a directing body and to be loyal to the company.

Members of a management or supervisory board who cause damage to the company by violation of their duties (e.g. by breaching their duty of care) are jointly and severally liable to the company. A member of a management or supervisory board will not suffer liability if he or she acts pursuant to a lawful resolution of the general meeting or any other competent body or if he or she proves that he or she performed his or her obligations with due diligence. A claim for payment of compensation to the company for damage may also be submitted by a creditor of the company if the assets of the company are not sufficient to satisfy the claims of the creditor.

#### **3.2 Reporting requirements**

An annual report which consists of a management report and annual accounts and which has been approved by the shareholders must be submitted to the Commercial Register together with a profit distribution proposal and auditor's report, if compulsory, not later than 6 months after the end of the financial year.



### 3.3 Requirements for local shareholding / directors

A shareholder may be either Estonian or a foreign individual or company.

There is no separate legal concept of director in Estonian commercial law, but the member of the management board could be called director. A director must be a natural person with active legal capacity. There are no requirements regard to the citizenship. A person with respect to whom a court has imposed a prohibition on acting as a member of the management board or a prohibition to engage in enterprise, a person who is prohibited from operating within the same area of activity as the branch, or a person who is prohibited to act as a member of the management board based on law or a court decision shall not be a director.

Directors of Estonian companies are subject to a range of duties imposed by the Commercial Code, by the articles of association of the Company and by the resolution of the shareholders. For example, the members of the management board shall a) perform their duties with due diligence; b) preserve the business secrets of the company; c) represent and manage the company; d) in managing, adhere to the lawful orders of the supervisory board/shareholders; e) organize the accounting of the company.

### 3.4 Protection of minority shareholders

#### *Public limited company*

Any shareholder (without having to meet a qualified minority requirement) has the right to receive information on the activities of the public limited company from the management board at the general meeting of shareholders, and the right to file an action to

the court to demand the revocation of the shareholders' resolution.

Qualified minority consists of any shareholder(s) holding at least 10% of the share capital of the public limited company. In case of listed public limited companies, the qualified minority may be higher (at least 20% of the share capital) in certain cases. Minority shareholders with qualified minority are protected by the Commercial Code in several aspects.

Firstly, if it is demanded by minority shareholders with qualified minority, the management board shall call a special general meeting. They also may demand the inclusion of additional issues on the agenda of the general meeting if the respective demand has been submitted no later than 15 days before the general meeting is held. Minority shareholders may submit to the public limited company a draft of the resolution in respect to each item on the agenda.

Secondly, shareholders whose shares represent at least one-tenth of the share capital may request the removal of a member of the supervisory board by a court. They may also request the meeting of the supervisory board to be called,

Thirdly, at the general meeting of shareholders, minority shareholders who hold at least 10% of the shares may demand a resolution on conduct of a special audit on matters regarding the management or financial situation of the public limited company, and the appointment of an auditor for the special audit. If the general meeting does not decide on conduct of a special audit, minority shareholders may request that a special audit be conducted and that an auditor for the special audit be appointed by a court.

Fourthly, minority shareholders who hold at least 10% of the shares may request the change of an auditor appointed by the general meeting from a court if doubt exists concerning the impartiality of the person appointed by the general meeting. The minority shareholders may request of the private limited company that the auditor who prepared the sworn auditor's report participate in the making of the decision to approve the annual report, and provide explanations concerning the sworn auditor's report if the shareholders have submitted the corresponding written request at least five days before the general meeting.

Fifthly, a court shall appoint the liquidators if this is requested by shareholders whose shares represent at least one-tenth of the share capital. Based on the demand of the minority shareholders, a court may recall a liquidator who is a member of the management board, or who has been appointed in accordance with the articles of association or by a resolution of the shareholders, and to appoint a new liquidator.

#### *Private limited company*

Any shareholder (without having to meet a qualified minority requirement) has the right to receive information from the management board on the activities of the private limited company and to examine the documents of the private limited company, and the right to file an action to the court to demand the revocation of the shareholders' resolution which conflicts with the law or the articles of association.

Qualified minority consists of any shareholder(s) holding at least 10% of the share capital. Minority shareholders with qualified minority have the following additional rights.

First, they may demand a meeting of shareholders. They also may demand the inclusion of additional issues on the agenda.

Secondly, if the private limited company does not have a supervisory board, minority shareholders with qualified minority may, with good reason, request the removal of a member of the management board by a court.


Thirdly, minority shareholders with qualified minority may demand a resolution on conduct of a special audit on matters regarding the management or financial situation of the private limited company, and the appointment of an auditor for the special audit by a resolution of the shareholders. If the shareholders do not decide on conduct of a special audit, minority shareholders with qualified minority may request that a special audit be conducted and that an auditor for the special audit be appointed by a court.

Fourthly, minority shareholders with qualified minority may request the court to recall and appoint the liquidators.

#### **4. Foreign Investment, Thin Capitalization, Residency and Material Visa Restrictions**

##### **4.1 Related-parties' transactions**

If the price of a transaction concluded between a resident legal person and a person associated with the resident legal person differs from the market value of the above transaction, income tax shall be imposed on the amount which the taxpayer would have received as income or the amount which the taxpayer would not have incurred as expenses if the transfer price had conformed to the market value of the transaction. The difference is taxed with CIT as if it was a distribution of profit. All transactions with associated persons must be duly documented by the Estonian company and in case the



associated person is an off-shore entity there are additional requirements to such documentation.

#### **4.2 Permanent establishment**

Permanent establishment means a business entity through which the permanent economic activity of a non-resident is carried out in Estonia. A permanent establishment is created because of economic activity which is geographically enclosed or has mobile nature, or because of economic activity conducted in Estonia through a representative authorised to enter into contracts on behalf of the non-resident. When a non-resident carries on business in Estonia through a permanent establishment situated in Estonia, the income which the permanent establishment might be expected to derive if it were a distinct and separate taxpayer engaged in the same or similar activities under the same or similar conditions and dealing wholly independently of the non-resident of which it is a permanent establishment shall be attributed to the permanent establishment.

#### **4.3 Withholding taxes**

Withholding tax is applied to certain types of income earned by Estonian tax residents and by tax non-residents. The income tax withheld is 20% or a lower rate of 10% for some types of income. For example, income tax is withheld from salaries, wages and other remuneration subject to income tax paid to a resident natural person and remuneration paid to members of the management and controlling bodies of a legal person.

No withholding taxes on dividends.

#### **4.4 Further corporate tax exemptions**

There are tax exemptions available for resident legal persons and non-resident legal persons acting through its permanent

establishment in Estonia. If the conditions in Income Tax Act are fulfilled, the income tax is not charged on dividends or on payments upon a reduction in share capital or contributions, redemption of shares or liquidation of a legal person.

#### **4.5 Corporate Income Tax**

Resident companies and permanent establishments of the foreign entities (including branches) are subject to income tax only in respect of distributed profits (both actual and deemed), including dividends, liquidation proceeds, fringe benefits, gifts and donations, non-business expenses, etc. All distributions are subject to income tax at the rate of 20/80 of the net amount of the taxable distribution (i.e. 20% of the gross amount). As of 2019 a lower tax rate will be applied to dividends that are paid out regularly. Tax rate on regular dividends is 14/86 of the net amount (14% of the gross amount).

#### **4.6 Taxation of Non-Residents**

Non-resident taxpayers are only liable for income tax regarding specific categories of Estonian-sourced income. Such taxable income includes business income, income derived from commercial leases and royalties, interest received from contractual investment funds and other pool of assets whose main asset consists of Estonian immovables (exceptions apply), etc. No additional tax is levied on dividends received from Estonian companies.

Income tax is charged on gains derived by a non-resident from transfer of property if:

- the sold or exchanged immovable is located in Estonia;

- the movable was subject to entry in an Estonian register prior to the transfer;
- the timber felled on an immovable located in Estonia was transferred;
- the transferred real right or the right of claim is related to an Estonian immovable;
- the holding is transferred or returned by a person who at the time of the transfer or return owned at least a 10% holding in a company, contractual investment fund or other pool of assets, whose property directly or indirectly comprised at least 50% Estonian immovables, as of the transfer or during a certain period within two years immediately preceding the transfer or return;
- gains were derived upon liquidation of a contractual investment fund or other pool of assets if the abovementioned condition regarding Estonian immovables is met.

Permanent establishments of non-residents are subject to corporate income tax on the same grounds as resident corporations (i.e., only profit distributions, granted fringe benefits, gifts, and donations, etc., are subject to income tax).

Applicable tax treaties must be considered. Estonia currently has 58 tax treaties in force and another 9 are being prepared (the list may be found at: <http://www.fin.ee>).

#### **4.7 Harmonization with EU tax legislation**

Estonia joined the European Union on 1 May 2004. In relation to that EU Directives concerning taxation were incorporated in to the Income Tax Act.

#### **4.8 Restrictions on remitting funds out of the jurisdictions (withholdings, etc.)**

There is no withholding tax on dividends in Estonia. Full participation exception for dividend income received from EEA or Switzerland located subsidiaries, where company's shareholding is at least 10%. This dividend income is exempt from CIT when distributed further to shareholders. In case of subsidiaries located outside of the EEA or Switzerland, "subject to tax" condition applies, i.e. dividends received from subsidiaries are tax exempt upon further distribution, if income tax has been withheld abroad or paid from the underlying profit. The exception does not apply in case the subsidiary is located in a low tax rate territory.

#### **4.9 Residency and visas**

Estonia is a member of the European Union and it is a Schengen country. The basic rules regarding EU and non-EU nationals are as follows

##### **4.9.1 Citizens of the European Union**

A citizen of the EU (or of the EEA or Swiss Confederation) has the right to stay and work in Estonia based on a valid travel document or an identity card for the period of up to 3 months without registration of the right of residence. An EU citizen shall obtain the right of residence upon registration of his/her place of residence located in Estonia with the local government authority nearest to his/her place of residence. EU citizens will obtain a right to reside in Estonia for five years, a term which shall be extended automatically for a next period of five years, if the registered place of residence is continually in Estonia. The document certifying the right of residence of an EU citizen is the Estonian ID card which shall be applied for

within 1 month after the registration of residence.

A citizen of the EU who has permanently (at least 183 days during a year) resided in Estonia for a period of five consecutive years based on a temporary right of residence is entitled to a permanent right of residence.

#### 4.9.2 Visa Requirements

In addition to citizens of EU or EEA or any third-country national holding a residence permit of a Schengen State, there are other countries' citizens who do not need a visa to enter Estonia for short-term stays. The list of these countries may be found at [www.vm.ee](http://www.vm.ee).

If a visa is required, generally the visa applicant must apply to the appropriate Estonian embassy or consulate in person. The application package normally includes a valid travel document, a photo, a health insurance policy valid in Schengen countries and a filled in application form signed personally by the applicant. A state duty of between EUR 60-80, depending on the type of the visa, must also be paid. Visa types include e.g. a short-term visa for stays up to 90 days during 6 months in Schengen area and a long-stay visa for single or multiple entries into Estonia with a period of stay up to 180 days and with a period of validity up to twelve months.

A foreigner staying in Estonia based on a visa or legally visa free is permitted to work in Estonia temporarily for up to 6 months during a year, if his/her short-term employment has been successfully registered in the Police and Border Guard Board by his/her employer prior to the commencement of work.

#### 4.9.3 Residence Permits

There are no general restrictions for foreigners to own a business in Estonia. Although a residence permit is not required to own a business, it is possible to apply for a temporary residence permit to operate a business. Such residence permit may be issued to a foreigner who owns shares in an Estonian company if the business is necessary for the national interest of developing the Estonian economy and the foreigner has invested in into business activity in Estonia a capital sum in the amount of at least EUR 65,000.

A foreigner (other than the citizen of EU, EEA, or Swiss Confederation) is required to have a residence permit to reside and work in Estonia for a time longer than allowed based on visa and registration of short-term employment.

As a rule, an application for a residence permit should be submitted to an Estonian embassy or consulate. The state duty for processing an application for a residence permit for employment is EUR 120 and for a temporary residence permit for business EUR 180. A bit lower rate applies in case the application may be submitted with Police and Border Guard Board in Estonia. A decision on the issuance of the permit will be taken within two months.





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# INTERNATIONAL LAWYERS NETWORK



REINHART MARVILLE TORRE  
ESTABLISHING A BUSINESS ENTITY IN FRANCE

## ESTABLISHING A BUSINESS ENTITY IN FRANCE

### 1. Types of business entities

#### 1.1 Types of entities available through which to conduct business

Business may be conducted in France either through a French branch of a foreign company (1) or through a French company (2). Both are considered to be direct investment in France.

##### (1) Branch

A branch is a permanent place of business established by a foreign company in France. It is not recognized under French law as a separate legal entity. All its rights and obligations constitute the rights and obligations of the foreign company.

The foreign company appoints the representative of the branch. His/her authority, revocation of that authority, remuneration and liability are therefore governed by the law applicable to the company.

##### (2) Companies

A variety of forms of limited and unlimited liability companies exist under French law; these are classified as either commercial (the form for carrying on commercial activities) or civil. The type of company most likely to be encountered by a foreign investor is the limited liability company, of which three distinct forms exist in France: the société anonyme (“SA”), the société à responsabilité limitée (“SARL”) and the société par actions simplifiée (“SAS”).

#### 1.2 Matters to be considered when choosing a particular business entity type

In considering whether to establish a branch or a company, various tax considerations must be considered.

The establishment of a branch is slightly simpler since it is not subject to all the formalities provided for by law for the incorporation of a company.

A French branch office has no share capital, no articles of association (statutes) and does not hold shareholders' meetings; however, it is obliged to file tax returns in the same way as a company.

For labour law purposes, there is no substantial difference between a branch and a subsidiary.

From an administrative standpoint, a branch is easier to manage than a subsidiary but may raise issues in specific circumstances, for instance because the legal rules applicable to a branch are less clearly defined.

In terms of sale of a business, it is normally easier and less costly to sell a subsidiary than a branch, because in the latter case there may be substantial stamp duties (although there are circumstances where these can be reduced e.g. partial contribution of assets within certain merger laws).

In summary, a branch is simple to set up, and is useful when commercial activities in France are just beginning. Later, however, it might prove more expedient to establish a subsidiary. Subject to specific tax considerations, the incorporation of a subsidiary is more frequently recommended.

## 2. Steps and Timing to Establish a Pty Limited company

### 2.1 Brief overview of steps to incorporate/constitute each

#### (1) Branch

The registration of a branch requires the provision of various documents (e.g. commercial lease, translation of the articles of association of the foreign company, decision of the board of directors (or equivalent) to open the establishment, name of the local representative responsible for its management) to the commercial court of the place of establishment. The registration may take 3 to 4 days as from filing.

#### (2) Company

Commercial companies must be registered with the local Registry of Commerce and Companies (“registre du commerce et des sociétés”).

1. Drafting of the articles of association
2. Signature of a lease or domiciliation agreement (or letter)
3. Opening of a bank account where the share capital will be deposited; this account is opened in the name of the company in the process of being incorporated
4. Transfer of the share capital by the shareholder(s) to such bank account
5. Obtaining of letters pursuant to which the statutory auditors (if required) accept their office
6. Signature of the articles of association by the shareholder(s)

7. Legal announcements and formalities with the commercial court

8. Obtaining of the final corporate identification number

Under normal circumstances, the incorporation would take approximately a week from receipt of all the incorporation documents duly signed. Delays often result from the following matters:

- (i) selection of the place of the registered office;
- (ii) selecting the French statutory auditor (if any);
- (iii) choosing the French bank and operating the transfer of funds

## 3. Governance, Regulation and Ongoing Maintenance

### 3.1 Brief summary of regulation of each type and ongoing maintenance, reporting requirements

See comparison chart attached.

### 3.2 Requirements for local shareholding/directors

Local shareholding:

- There are no general requirements concerning shareholders (individual or legal entity) but specific restrictions may apply with respect to regulated sectors of activity in France. For example, when certain regulated professional activities are exercised in France through companies, the majority shareholding must be constituted by individuals who are licensed in France to exercise the relevant regulated activity (e.g. lawyers, pharmacists, biologists, accountants, statutory auditors...).

- Furthermore, foreign shareholders must comply with declaratory obligations or must obtain permits or authorizations in some cases which are outlined in section 4 below.

#### Local managing directors:

- Foreign managing directors who do not wish to reside in France are exempt from the requirement to hold a temporary residence permit or any other specific authorization.
- Foreign managing directors of French companies who wish to reside and exercise commercial activities in France must be in possession of a temporary residence permit (“carte de séjour temporaire”) which allows the exercise of such commercial activities.
- However, EU, EEA or Swiss nationals who wish to reside and exercise commercial activities in France only must be registered with the municipal authority of their residence.
- Local managing directors must provide affidavits of parentage and non-conviction and file them with the Registry of Commerce and Companies.

### 3.3 Minority shareholders’ rights and protection

Minority shareholders may have specific protection rights negotiated in the articles of association or via shareholders’ agreements. In addition, French law grants specific rights to shareholders (either to all shareholders or specifically to minority shareholders) such as:

- rights of information (depending on the type of company).
- right to participate and attend all shareholders’ meetings.
- in companies having the form of a SA or SAS, shareholders holding one twentieth (5%) of the share capital may (i) ask the commercial court to dismiss the statutory auditor(s) (ii) address questions to the President, twice a year, on any aspect which may compromise the continuation of the company’s business (iii) ask the commercial court to appoint an expert to produce a report on one or several management activities of the company.
- right to the profits: it is forbidden to allocate the whole profits or losses to one or several shareholders, or to deprive a shareholder of any share in the profits. The exempting of a shareholder from any contribution to losses is also forbidden.
- Preferential subscription rights: in certain forms of companies (SA and SAS), each shareholder has a preferential subscription right in the case of a share capital increase.
- Abuse of a majority position: minority shareholders who suffer an abuse by the majority can bring a civil action (there is an abuse of majority if the decision of the majority has been taken contrary to the general interests of the company and with the sole purpose of favoring the majority shareholders to the detriment of the minority shareholders). Where a disagreement arises between shareholders, it is possible for a shareholder to ask the court to order the liquidation of the company.

- Any shareholder may ask the court to hold the corporate officers liable and to obtain damages for the losses suffered personally by the shareholder, as distinct from the losses suffered, as the case may be, by the company (Article L225-252 of the Commercial Code).
- Some decisions require the unanimous agreement of all the shareholders (e.g. any decision which increases the current commitments of a shareholder, change of the nationality of a company).

#### **4. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions**

##### **4.1 Any significant barriers to entry for an offshore party**

Access to certain regulated activities may be reserved to French or EU nationals or nationals of a country which has concluded a reciprocal treaty with France (e.g. architects, doctors, biologists, lawyers, statutory auditors...). Exercising regulated activities may require conditions of holding a particular diploma or professional experience, or even the obtaining of an authorization issued by an administrative authority.

Furthermore, majority participation in companies active in certain regulated sectors may be reserved to professionals in that sector.

For example:

- For some regulated activities which can be exercised in France through companies, the shareholding of non-professionals is limited (e.g. third party can hold a maximum of 25% of the share capital of biology laboratory).

- Foreign investors may hold the majority of the share capital of an agricultural company only if they are in possession of an agricultural professional permit issued by the agricultural authority of the region where the farm is located.
- Foreign investors may not cumulatively hold more than 20% of the share capital of a media company.

Furthermore, prior authorization may be mandatory in restricted areas, as explained hereunder.

##### **4.2 Any Capitalisation obligations**

The net equity of a company having the form of a SA, SAS or SARL must be at least equal to half of the share capital. If any such company suffers losses causing its net asset value to fall below one half of its share capital, the shareholders must decide, within a four-month period following the approval of the accounts which revealed such loss, whether the company must be dissolved or not. If the shareholders decide to continue the company's operations, the company must increase its net asset value to at least one half of its share capital at the latest at the close of the second fiscal year following the fiscal year during which the situation has been acknowledged.

##### **4.3 Any special business or investment visa issues**

Investments and acquisitions by non-resident (individuals or legal entities) in France are unrestricted and only require (i) a declaration for statistical purposes, (ii) except in the case of transactions in sensitive areas for which specific investment-control rules apply and prior authorization is mandatory.



## (i) Statistical declarations:

- Foreign investment which exceeds EUR 15 million and corresponds to the acquisition of at least 10% of the share capital or voting rights of a French company or real estate investments must be declared to the French central bank within 20 working days after the investment.
- The following transactions are also subject to statistical declaration to the Treasury Department : (i) the creation or development of a French company, which share capital is held by foreign investors, amounting to more than EUR 1.5 million, (ii) the acquisition of real estate by foreign investors amounting to more than EUR 1.5 million, (iii) liquidating a direct foreign investment in France, (iv) realization of a transaction authorized by the ministry of Economy and Finance, and (v) the reduction of a foreign participation in the share capital of a French company or any event modifying the activity or the existence of such French company.

## (ii) Prior authorization in sensitive areas:

Several sectors of activity are deemed to be sensitive because they affect public interests:

- activities involved, even occasionally, in the exercise of the public authority;
- activities which are likely to infringe public order, public

security or national defence interest;

- activities carried out in the field of weapons research, production, or trade of weapons...

A non-resident contemplating a direct investment in any of the aforementioned restricted areas must first file a declaration with the Ministry of Economy and Finance (Treasury Department) setting out the details of the operation and obtain its prior authorization.

A non-resident (individual or entity) may proceed with the investment unless the Treasury has objected within two months of the filing of such declaration.

#### 4.4 Restrictions on remitting funds out of the jurisdictions (withholdings, etc.)

Branch withholding tax: profits earned by a French branch of a foreign company and distributed to the foreign shareholders are subject to a withholding tax of 30% on after-tax income. However, if the foreign company is (i) located in the EU and is subject to income tax with no possibility of opting out or of being exempt and (ii) the income is taxable in the relevant EU member state, such branch tax is not applicable. This tax may be reduced or eliminated by an applicable double tax convention. Although branch withholding tax normally applies to undistributed profits, such profits may be exempted from the tax if an application is filed with the tax authorities and if certain requirements are met.

Dividends paid to a non-resident (individual or legal entity) by a French company are subject to a withholding tax amounting to 30%. The rate of such withholding tax increases to 75% if the dividends are paid to a non-resident located in a non-cooperative

country. Such withholding tax may however be reduced or eliminated under an applicable tax convention or EU directive. For example, under the parent-subsidiary directive, dividends paid by a French company to an EU parent company are exempt from withholding tax if the parent holds for at least two years more than 10% of the share capital of the French distributing company.

Commissions, royalties, and fees paid to a non-resident for services performed or used in France are subject to a domestic withholding tax of 33.33%. This tax may be reduced or eliminated by an applicable tax convention or where the EU interest and royalties' directive applies. Where the payment is made to an entity or individual located in a non-cooperative territory, a 75% withholding tax applies.

Interest payments made to a non-resident (individual or legal entity) are generally exempt from withholding tax in France. However, if the payment is made to a non-resident (entity or individual) located in a non-cooperative territory, a 75% withholding tax applies.

## TABLE OF COMPARISON BETWEEN SA / SARL / SAS / FRENCH BRANCH OF A FOREIGN COMPANY

	SA	SARL	SAS	FRENCH BRANCH
<b>GENERAL ISSUES / INCORPORATION</b>				
<b>Number of shareholders</b>	<ul style="list-style-type: none"> <li>at least 2</li> <li>corporate entities or individuals</li> </ul>	<ul style="list-style-type: none"> <li>at least 1 and no more than 100</li> <li>corporate entities or individuals</li> </ul>	<ul style="list-style-type: none"> <li>at least 1</li> <li>corporate entities or individuals</li> </ul>	N/A
<b>Minimum share capital</b>	<ul style="list-style-type: none"> <li>€ 37,000</li> <li>at least 1/2 paid up</li> </ul>	<ul style="list-style-type: none"> <li>no minimum</li> <li>at least 1/5<sup>th</sup> paid up</li> </ul>	<ul style="list-style-type: none"> <li>no minimum</li> <li>at least 1/2 paid up</li> </ul>	
<b>Shares</b>	<ul style="list-style-type: none"> <li>registered shares (<i>actions nominatives</i>)</li> </ul>	<ul style="list-style-type: none"> <li>membership shares (<i>parts sociales</i>)</li> </ul>	<ul style="list-style-type: none"> <li>registered shares (<i>actions nominatives</i>)</li> </ul>	
<b>Nature of contributions</b>	<ul style="list-style-type: none"> <li>cash or contributions in kind</li> </ul>	<ul style="list-style-type: none"> <li>cash, contributions in kind or performance of professional services</li> </ul>	<ul style="list-style-type: none"> <li>cash or contributions in kind or performance of professional services</li> </ul>	
<b>Payment of contributions</b>	<ul style="list-style-type: none"> <li>contributions in kind: fully paid-up upon incorporation</li> <li>cash contributions: at least 1/2 paid-up on incorporation and remainder within five years</li> </ul>	<ul style="list-style-type: none"> <li>contributions in kind: fully paid-up upon incorporation</li> <li>cash contributions: at least 1/5<sup>th</sup> paid up on subscription and remainder within five years</li> </ul>	<ul style="list-style-type: none"> <li>contributions in kind: fully paid-up upon incorporation</li> <li>cash contributions: at least 1/2 paid-up on incorporation and remainder within five years</li> </ul>	
<b>MANAGEMENT</b>				
<b>Management</b>	<p><u>SA with a board of directors</u></p> <ul style="list-style-type: none"> <li>3-18 <i>administrateurs</i> (directors):               <ul style="list-style-type: none"> <li>individuals or corporate bodies</li> </ul> </li> </ul> <p><u>SA with a directorate and a supervisory board</u></p> <ul style="list-style-type: none"> <li>directorate: 2-5 members, 7 if the company is listed;</li> <li>several directors possible or 1 only if capital &lt; 150,000 euros;</li> <li>supervisory board: 3-18 members, all shareholders</li> </ul>	<p>The sole shareholder is not free to set out in the articles of association the type of management structure required and the rules governing its operation.</p> <p>The SARL is managed by one or more individuals (the "<i>gérants</i>") who may (but need not) be shareholders. There is no board of directors as such.</p>	<p>The shareholder(s) is/are free to set out in the articles of association the type of management structure required and the rules governing its operation.</p> <p>The only compulsory requirement is that a <i>président</i> (equivalent of a CEO) must be appointed. This <i>président</i> may be an individual or a legal entity (in this case, it is represented by the legal representative of such entity).</p>	<p>The shareholder(s) is/are free to appoint a representative of the branch.</p>

<p><b>Responsibility for management</b></p>	<p><u>SA board directors</u></p> <ul style="list-style-type: none"> <li>• directors can choose between:                     <ul style="list-style-type: none"> <li>- a <i>president</i> to assume all management powers and chair the board of directors, or</li> <li>- a managing director (<i>directeur général</i>) to assume all management powers and a <i>chairman of the board</i> with a representative, organisational and supervisory role</li> </ul> </li> <li>• the managing director can request the appointment of 2-5 deputy managing directors (<i>directeurs généraux délégués</i>) by the board of directors to assist him</li> </ul>	<ul style="list-style-type: none"> <li>• <i>gérant(s)</i></li> </ul>	<ul style="list-style-type: none"> <li>• president, in the absence of provision to the contrary in the articles of association</li> </ul>	<ul style="list-style-type: none"> <li>• The representative of the branch is appointed by the foreign company. His/her authority, revocation of that authority, remuneration and liability are therefore governed by the law applicable to the foreign company.</li> </ul>
<p><b>Appointment of managers</b></p>	<p><u>SA with a board of directors</u></p> <ul style="list-style-type: none"> <li>• Directors: the first directors are appointed in the articles of association constituting the company; then by the shareholders</li> <li>• Chairman of the board: by the board</li> <li>• General Manager: by the board</li> </ul> <p><u>SA with a directorate and a supervisory board</u></p> <ul style="list-style-type: none"> <li>• Members of the directorate appointed by the supervisory board (including the president of the directorate and, as the case may be, the managing directors);</li> <li>• members of supervisory board appointed by the shareholders</li> </ul>	<ul style="list-style-type: none"> <li>• first <i>gérant</i>: constitutive articles of association or by subsequent shareholders' meeting</li> <li>• subsequent <i>gérants</i>: by shareholders' meetings</li> </ul>	<ul style="list-style-type: none"> <li>• procedure freely set by the articles of association</li> </ul>	

<p><b>Removal of managers</b></p>	<p><u>SA with a board of directors</u></p> <ul style="list-style-type: none"> <li>• directors: by shareholders' meeting</li> <li>• Chairman of the board: by the board</li> </ul> <p><u>SA with a directorate and a supervisory board</u></p> <ul style="list-style-type: none"> <li>• members of the directorate revoked by the shareholders or, if the articles of association allow it, by the supervisory board;</li> <li>• members of the supervisory board revoked by the shareholders</li> </ul>	<ul style="list-style-type: none"> <li>• by shareholders' meetings</li> </ul> <p>If the sole shareholder dismisses the <i>gérant</i> without lawful cause, the <i>gérant</i> can file a claim for damages. Lawful cause does not necessarily require mismanagement by the <i>gérant</i>; for example, loss of confidence in the <i>gérant</i>, significant variance in points of view <i>vis-à-vis</i> the management of the company, etc. may be considered as lawful cause.</p>	<ul style="list-style-type: none"> <li>• procedure freely set by the articles of association</li> </ul>	
<p><b>Powers</b></p>	<p><u>SA with a board of directors</u></p> <ul style="list-style-type: none"> <li>• <i>Managing directors</i> are fully empowered to act on behalf of the company and may bind the company by action beyond the company's objects</li> <li>• articles of association may impose limits which are not enforceable against third parties</li> </ul> <p><u>SA with a directorate and a supervisory board</u></p> <ul style="list-style-type: none"> <li>• members of the directorate have extensive powers to act on behalf of the company within the corporate purpose</li> <li>• members of the supervisory board: permanent control of the management</li> </ul>	<ul style="list-style-type: none"> <li>• <i>gérant</i> is fully empowered to act on behalf of the company and may bind the company by action beyond the company's objects</li> <li>• <i>articles of association</i> may impose limits which only bind third parties with specific knowledge</li> </ul>	<ul style="list-style-type: none"> <li>• President is fully empowered to act on behalf of the company and may bind the company, including in respect of actions that exceed the company's objects</li> <li>• A managing director (<i>directeur général</i>) may also be fully empowered to act on behalf of the company and may bind the company, including in respect of actions that exceed company's objects if specific provisions in the <i>articles of association</i> allow this</li> <li>• <i>articles of association</i> may impose limits on the powers of the President and/or managing director(s) which only bind third parties with specific knowledge of such limitations of powers</li> </ul>	
<p><b>Liability</b></p>	<ul style="list-style-type: none"> <li>• possible tort and criminal liability for breach of legal provisions of the articles of association or of the duty of care towards the company</li> <li>• specific sanctions under bankruptcy law if the company becomes insolvent</li> </ul>	<ul style="list-style-type: none"> <li>• possible tort and criminal liability for breach of legal provisions of the articles of association or of the duty of care towards the company</li> <li>• specific sanctions under bankruptcy law if the company becomes insolvent</li> </ul>	<ul style="list-style-type: none"> <li>• possible tort and criminal liability for breach of legal provisions of the articles of association or of the duty of care towards the company</li> <li>• specific sanctions under bankruptcy law if the company becomes insolvent</li> </ul>	



<p><b>Regulated agreements</b></p>	<ul style="list-style-type: none"> <li>• agreements between the company and, directly or indirectly,             <ul style="list-style-type: none"> <li>➢ one of its directors or its managing director(s), or</li> <li>➢ one of its “<i>directeurs généraux délégués</i>”, or</li> <li>➢ one of its shareholders holding more than 10% of the voting rights or if the shareholder is a company, its controlling shareholder,</li> </ul>             require prior authorisation by the board of directors, a special auditor's report and approval by shareholders' annual general meeting           </li> <li>• agreements entered into in the normal course of business and under normal conditions do not require any prior approval; the chairman of the <i>board of directors</i> must be notified of such agreements and provide a list of such agreements to the <i>board</i> and auditors; except for agreements which, because of their amount or their purpose, are not significant for either of the parties</li> <li>• an individual director or corporate officer is strictly prohibited from borrowing money from the company, obtaining a guarantee or putting his/her shareholder's account with the company in overdraft. Those agreements are not prohibited if the director or corporate officer is a legal entity.</li> </ul>	<ul style="list-style-type: none"> <li>• agreements between the company and, directly or indirectly,             <ul style="list-style-type: none"> <li>➢ a <i>gérant</i> or</li> <li>➢ a shareholder</li> </ul>             require approval by shareholders' meeting following a report by the <i>gérant</i> or the statutory auditor (if any)           </li> <li>• if there is no statutory auditor and if the <i>gérant</i> is not also a shareholder, agreements between the company and this <i>gérant</i> require the prior authorisation of the shareholders</li> <li>• agreements entered into in the normal course of business and under normal conditions do not require any prior approval;</li> <li>• a <i>gérant</i> or a shareholder is strictly prohibited from borrowing money from the company, obtaining a guarantee or putting his/her shareholder's account with the company in overdraft. Those agreements are not prohibited if the <i>gérant</i> or the shareholder is a legal entity.</li> </ul>	<ul style="list-style-type: none"> <li>• agreements between the company and, directly or indirectly,             <ul style="list-style-type: none"> <li>➢ the president or</li> <li>➢ one member of any management body (if any) having managing powers, or</li> <li>➢ one of its shareholders holding more than 10% of the voting rights, or if the shareholder is a company, its controlling shareholder,</li> </ul>             require the approval by shareholders' meeting following a report by the statutory auditor (if any) or the president           </li> <li>• agreements entered into in the normal course of business and under normal conditions do not require any prior approval;</li> <li>• In case of a sole shareholder, such agreements are only mentioned in the registry of the minutes of the sole shareholder of the company.</li> <li>• the president and any individual director or corporate officer (if any) are strictly prohibited from borrowing money from the company, obtaining a guarantee or putting his/her shareholder's account with the company in overdraft. Those agreements are not prohibited if the president/corporate officer is a legal entity.</li> </ul> <p>Articles of association may impose a stricter procedure</p>	<p>N/A</p>
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STATUS OF SHAREHOLDERS				
<b>Liability</b>	Limited to amount of contributions	Limited to amount of contributions	Limited to amount of contributions	N/A
<b>Proof of ownership</b>	Shareholders' accounts and share transfer register	Articles of association	Shareholders' accounts and share transfer register	N/A
<b>Participation in decisions</b>	Participate in meetings	Participate in meetings	Participate in meetings	N/A
<b>Rights to information</b>	<ul style="list-style-type: none"> <li>at any time may request (<i>inter alia</i>):                             <ul style="list-style-type: none"> <li>annual accounts</li> <li>performance figures for the last 3 financial years</li> <li>articles of association</li> <li>list of members of the management bodies and auditors</li> </ul> </li> <li>before ordinary general meeting to approve the accounts must receive the formal documents (i.e. annual accounts management report, draft resolutions to be passed, auditor's report and may submit written questions which the management body addressed must collectively answer</li> </ul>	<ul style="list-style-type: none"> <li>at any time may request (<i>inter alia</i>):                             <ul style="list-style-type: none"> <li>annual accounts</li> <li>performance figures for the last 3 financial years</li> <li>articles of association</li> <li>list of <i>gérants</i> and auditors (if any)</li> </ul> </li> <li>15 days before ordinary general meeting must receive the formal documents (i.e. annual accounts, management report, draft resolutions to be passed, auditor's report (if any)) and may submit written questions which the <i>gérant</i> must answer</li> </ul>	Freely set by the articles of association	N/A
COLLECTIVE DECISION-MAKING				
<b>Procedure</b>	<ul style="list-style-type: none"> <li>general meetings and video-conference</li> <li>possible vote by post or by proxy</li> </ul>	<ul style="list-style-type: none"> <li>general meetings or written resolution or video-conference</li> <li>meetings are necessary:                             <ul style="list-style-type: none"> <li>to approve annual accounts</li> <li>if requested by several shareholders</li> </ul> </li> <li>possible vote by post or by proxy</li> </ul>	<ul style="list-style-type: none"> <li>general meetings, written resolutions or visio-conference</li> <li>voting procedure freely set by the articles of association</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>

		ORDINARY GENERAL MEETINGS		
Scope of competence	<ul style="list-style-type: none"> <li>approval of accounts (meeting must be held at least annually for this purpose)</li> <li>appointments and changes in membership of the management bodies and auditors</li> <li>approval of regulated agreements</li> </ul>	<ul style="list-style-type: none"> <li>approval of accounts (annual meeting must be held for this purpose)</li> <li>appointment and removal of <i>gérants</i></li> <li>appointment of auditors</li> </ul>	<ul style="list-style-type: none"> <li>procedure freely set by the <i>articles of association</i></li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>
Passing of resolutions	<ul style="list-style-type: none"> <li>majority of shareholders in attendance or represented</li> </ul>	<ul style="list-style-type: none"> <li>simple majority of the shares</li> <li>articles of association may provide for higher majority (unanimity is prohibited for dismissal of a <i>gérant which is also a shareholder</i>)</li> </ul>	<ul style="list-style-type: none"> <li>procedure freely set by the <i>articles of association</i></li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>
		EXTRAORDINARY GENERAL MEETINGS		
Scope of competence	<ul style="list-style-type: none"> <li>decisions requiring amendment of articles of association</li> </ul>	<ul style="list-style-type: none"> <li>decisions requiring amendment of <i>articles of association</i></li> </ul>	<ul style="list-style-type: none"> <li>procedure freely set by the articles of association</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>
Passing of resolution	<ul style="list-style-type: none"> <li>two-thirds majority of shareholders in attendance or represented</li> </ul>	<ul style="list-style-type: none"> <li>three-quarters majority of the shares for most resolutions</li> <li>higher majority for certain specific resolutions</li> </ul>	<ul style="list-style-type: none"> <li>procedure freely set by the articles of association although certain decisions (e.g. which increase shareholders' liabilities) require a unanimous vote, for example, the modification or deletion of the prior approval clause in respect of a share transfer</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>

**DECISION MAKING IF SINGLE SHAREHOLDER**

<p>Scope of competence</p>	<p>NA</p>	<p>Collective decisions of the shareholders are replaced by the decision of the sole shareholder.</p> <p>The sole shareholder alone must make the following decisions:</p> <ul style="list-style-type: none"> <li>- approval of the accounts and allocation of the profits,</li> <li>- appointment of the statutory auditors (if required; see more details below),</li> <li>- appointment and revocation of the manager,</li> <li>- any decision resulting in an amendment of the articles of association (increase or reduction in the capital, issue of securities, merger, de-merger or partial contribution, transformation into another form),</li> <li>- winding-up of the Company.</li> </ul>	<p>Collective decisions of the shareholders are replaced by the decision of the sole shareholder.</p> <p>The sole shareholder alone must make the following decisions:</p> <ul style="list-style-type: none"> <li>- approval of the accounts and allocation of the profits,</li> <li>- appointment of the statutory auditors,</li> <li>- appointment and revocation of the <i>president</i>,</li> <li>- any decision resulting in an amendment of the articles of association (increase or reduction in the capital, issue of securities, merger, de-merger or partial contribution, transformation into another form),</li> <li>- winding-up of the Company.</li> </ul>	<p>N/A</p>
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**SHARE TRANSFER**

<p>Restrictions on share transfer</p>	<ul style="list-style-type: none"> <li>• freely transferable unless otherwise provided by the articles of association</li> </ul>	<ul style="list-style-type: none"> <li>• freely transferable to other shareholders unless otherwise provided by the articles of association</li> <li>• requirements for transfer to third parties: consent of a simple majority of shareholders and those shareholders must represent at least 1/2 of the issued shares (unless a higher majority is provided in the articles of association)</li> </ul>	<ul style="list-style-type: none"> <li>• procedure freely set by the <i>articles of association</i></li> <li>• shareholders may opt for a lock-up clause (maximum ten years), pre-emption clause or squeeze-out clause</li> <li>• those clauses require the unanimity of shareholders</li> </ul>	<p>N/A</p>
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Formal requirements	Share transfer order	Must be evidenced in writing in a share transfer agreement;  The articles of association must be amended in accordance with such transfer and registered with the Registry of Commerce and Companies.	Share transfer order	N/A
Stamp duty	0,1% proportional fee, payable by the purchaser, considering a minimum fee amounting to EUR 25.  This deduction does not apply to the transfers of shares of real estate companies. In that case, the transfer of shares is subject to a 5% registration fee.	The transfer of shares is subject to a 3% registration fee on the transfer price, payable by the purchaser, considering a minimum fee amounting to EUR 25. However, a deduction equal to € 23,000 multiplied by the percentage of the transferred shares on the total issued shares is applicable on the transfer price. This deduction does not apply to the transfers of shares of real estate companies. In that case, the transfer of shares is subject to a 5% registration fee.	0.1% proportional fee, payable by the purchaser, considering a minimum fee amounting to EUR 25.  This deduction does not apply to the transfers of shares of real estate companies. In that case, the transfer of shares is subject to a 5% registration fee.	N/A
<b>ACCOUNTING AND FINANCIAL INFORMATION</b>				
Accounting and financial information	<ul style="list-style-type: none"> <li>balance sheet, profit and loss account and annex</li> <li>management report</li> </ul>	<ul style="list-style-type: none"> <li>balance sheet, profit and loss account and annex</li> <li>management report</li> </ul>	<ul style="list-style-type: none"> <li>balance sheet, profit and loss account and annex</li> <li>management report</li> </ul>	<ul style="list-style-type: none"> <li>the foreign company which has a French branch must file a copy of its foreign accounting documents (which have been drawn up, audited, and published in the state in which it is located), each year with the registry of the commercial court in France,</li> <li>The filed documents must be translated into French and certified by the depositors</li> </ul>
Losses	<ul style="list-style-type: none"> <li>net equity cannot be less than half the value of the share capital</li> </ul>	<ul style="list-style-type: none"> <li>net equity cannot be less than half the value of the share capital</li> </ul>	<ul style="list-style-type: none"> <li>net equity cannot be less than half the value of the share capital</li> </ul>	N/A



STATUTORY AUDITORS				
Statutory auditor	<ul style="list-style-type: none"> <li>at least one statutory auditor is required</li> </ul>	<ul style="list-style-type: none"> <li>necessary only if two of the following conditions are met at the end of the financial year:                             <ul style="list-style-type: none"> <li>- total balance sheet of at least €1,550,000</li> <li>- net turnover of at least €3,100,000</li> <li>- at least 50 employees</li> </ul> </li> <li>obligation ceases if at least two of the above conditions are not met during the two years preceding the expiry of auditor's term of office</li> </ul>	<ul style="list-style-type: none"> <li>Necessary if two of the following conditions are met at the end of the financial year:                             <ul style="list-style-type: none"> <li>- total balance sheet of at least €1,000,000</li> <li>- net turnover of at least €=2,000,000</li> <li>- at least 20 employees</li> </ul> </li> <li>Obligation ceases if at least two of the above conditions are not met during the two years preceding the expiry of auditor's term of office</li> <li><u>also necessary if the company controls another company or is controlled by another company</u></li> <li>obligation ceases if at least two of the above conditions are not met during the two years preceding the expiry of auditor's term of office</li> </ul>	N/A
Appointment	<ul style="list-style-type: none"> <li>first appointment by articles of association for 6-year term</li> <li>subsequent appointments by ordinary general meeting for renewable 6-year terms</li> <li>deputy auditor must be appointed to replace principal auditor in event of death or incapacity</li> </ul>	<ul style="list-style-type: none"> <li>appointed by ordinary shareholders' meeting for 6-year term</li> <li>deputy auditor must be appointed to replace principal auditor in event of death or incapacity</li> </ul>	<ul style="list-style-type: none"> <li>first appointment by <i>articles of association</i> for 6-year term</li> <li>deputy auditor must be appointed to replace principal auditor in event of death or incapacity</li> </ul>	N/A
Role	Certifies accounts	Certifies accounts	Certifies accounts	N/A



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# INTERNATIONAL LAWYERS NETWORK



**A. & K. METAXOPOULOS AND PARTNERS  
LAW FIRM**

**ESTABLISHING A BUSINESS ENTITY IN GREECE**

**ILN CORPORATE GROUP**

## ESTABLISHING A BUSINESS ENTITY IN GREECE

### 1. Types of Business Entities

The main business entities in Greece are the following: **i)** the Société Anonyme (S.A.); **ii)** the Private Company (P.C.); **iii)** the Limited Liability Company (Ltd); **iv)** the General Partnership and the Limited Partnership and **v)** the Branch. There are also several types of business entities that are used for specific purposes such as the very popular branches/offices of foreign shipping companies of art. 25 of law 27/1975 and the branches and companies of law 89/1967 (for the purposes of the present presentation, the branch, and the business entities of laws 27/1975 and 89/1967 are presented only briefly).

Furthermore, there are also specific types of companies that are used for specific types of undertakings such as the Maritime Company or the Maritime Company for Leisure Ships.

The basic distinctions between the companies are: **i)** the commercial character; **ii)** the legal personality and **iii)** the capital or personal character.

The commercial companies are treated as merchants (e.g. they have the obligation to have commercial/accounting books, they can go bankrupt etc.). Some companies are considered as commercial depending on their purpose (i.e. if their purpose is commercial) whether other companies are considered commercial by law (i.e. regardless of their purpose).

All the above-mentioned companies have a legal personality, meaning that they are independent subjects, separate from the partners, having their own rights and obligations. Furthermore, they have their own property/assets and they are not liable for the liabilities of the partners. Conversely, the

companies do not have any right over the personal property of the partners. The legal personality is granted after the conclusion of the articles of association and the compliance with the publicity/registration obligations that are designated to each type of legal entity/company.

The personal companies are focused on the personal, active participation of the partners, meaning that any accumulation of capital is also accompanied by a continuous labour/services and cooperation of the partners.

On the other hand, at the capital companies, the persons of the partners are irrelevant, the participation in the company is in principle transferable and the company is not affected by any changes of the partners.

However, in Greece, some types of capital companies have also more or less personal elements. The Société Anonyme is the archetypical capital company. The Private Company and the Limited Liability Company are also capital but with several personal elements, the latter more than the former. The Partnerships are personal companies.

#### 1.1 Description

##### 1.1.1 The Société Anonyme (S.A.)

The S.A. is a capital company, it has a legal personality and it is by law commercial. It can be private or listed. It is governed mainly by the law 2190/1920 which provides many compulsory provisions. It can be established by one or more persons, natural or legal entities. The capital is divided in shares, which are, in principle, transferable. The shares attribute to the shareholder rights such as participating and voting at the General Assembly, and receiving dividends.

The S.A. is suitable for large undertakings and/or when the interested parties do not want any personal element in their undertaking and/or they wish to be enabled to transfer their shares easily. The S.A. is a very popular business entity in Greece and in practice it is used not only for large undertakings but for medium and small as well.

### **1.1.2 The Private Company (P.C.)**

The P.C. is governed mainly by the law 4072/2012. It is a capital company (however, with several personal elements), it has a legal personality and it is commercial by law. It can be established by one or more natural or legal persons and there are no minimum capital requirements (the capital can be even zero). The capital is divided in “portions of participation”.

It is a quite new type of company with increasing popularity in Greece. It is suitable for small or medium sized undertakings and the law gives to the partners a wide contractual freedom as for regulating the company’s functions.

The P.C. is an intermediate capital company, between the S.A., which is a purely capital company, and the Ltd which is a capital company, but with many personal elements.

### **1.1.3 The Limited Liability Company (Ltd)**

The Ltd is a capital company, however it has many personal elements. It has a legal personality and it is by law commercial. It is governed mainly by the law 3190/1955. Most of the provisions are not mandatory, so the partners can agree otherwise. It can be established by one or more persons, natural or legal entities. The capital is divided in “portions of participation”, which are, in principle, transferable.

As the PC, the Ltd is suitable for small or medium sized undertakings, however, in the Ltd more emphasis is given to the personal elements than in the PC. It is preferable to those who wish to maintain personal relations with the company but do not want to be personally liable for its liabilities.

The Ltd was never as popular as the S.A. in Greece, even for medium size undertakings. Since the P.C. was established as a company type, the popularity of the Ltd was further decreased.

### **1.1.4 The General Partnership and the Limited Partnership**

Both the General Partnership and the Limited Partnership are companies with a legal personality and they are regarded as commercial if their purpose is such. They are governed mainly by the law 4072/2012 and the Civil Code.

Both types of partnership cannot be established or exist as single-member companies. Two partners at least are obligatory. The General Partnership consists of general partners, who administer and represent the company and are liable with their personal property for the liabilities of the company. On the other hand, the Limited Partnership consists of at least one general partner and one limited partner. The limited partner is not responsible for the liabilities of the company with its own property, unless it commits actions of representation (for such actions its liability will be unlimited as of the general partners). In principle, the limited partner is not entitled to represent the company or commit any actions of administration (however, the articles of association may provide otherwise).

Both types of partnerships are used mainly for small or medium sized undertakings.

Apart from the different position of the limited partners in Limited Partnerships, the law provisions are the same in both the above types of partnerships.

#### **1.1.5 The Branch**

Foreign companies may establish in Greece branches. The branches do not have a legal personality; however, they acquire a Greek tax number. A branch of a foreign company must register at the General Commercial Registry inter alia its articles of association and their amendments, its address, its name, its purpose, data about the company and the legal representatives.

#### **1.1.6 Branches/offices of foreign shipping companies of art. 25 of law 27/1975**

A widely used business entity in Greece in shipping business is the branch/office of art. 25 of law 27/1975, mainly due to the many tax exemptions that it enjoys.

The exclusive purpose of the branch/office must be the management, operation, charter, insurance, average adjusting and shipbroking. Moreover, a permit may be granted to maritime/ ship owning/management companies of salvors or tugs.

The branch/office is established after a permit granted by ministerial decision, following a submission of an application accompanied by the required documentation to the competent Ministry. The permit lasts for 5 years, although it is automatically renewable. The decision mentions the type of services of the branch and the terms of its operations.

The branches/offices enjoy the tax exemptions provided that they spend in Greece for their operations and their payments foreign exchange of at least USD 50,000 (or equivalent in Euros).

#### **1.1.7 Branches and companies of law 89/1967**

Foreign companies may also be established in Greece (either as companies or branches) according to the law 89/1967 with the exclusive purpose to provide at their central offices or to affiliated with them foreign companies' specific services (including consulting, accounting, production quality control, drafting of researches, plans and contracts, advertising and marketing, research, and development).

These companies are established by a Ministerial Decision, which defines their exclusive purpose. Thus, they are not allowed to any other operation that is not included in the Ministerial Decision for their establishment.

They must have at least 4 employees in Greece and to have as expenses for their operation in Greece at least 100.000 Euros annually.

The companies of law 89/1967 are taxed in Greece only for the income that they receive in Greece. Their net taxable income is calculated after the deduction of their expenses and of a minimum percentage of profit that is defined in the ministerial decision of their establishment and it cannot be less than 5% (cost-plus).



## 1.2 Matters to be considered when choosing a particular business entity type

### 1.2.1 The Société Anonyme (S.A.)

- The contributions of the shareholders can be in cash and in kind.
- The shareholders do not have personal liability for the liabilities of the company.
- The default rule is that the shares are transferable. However, the articles of association can establish restrictions at the transfer of the shares (e.g. without the consent of the company or by providing a preemption right to the existing shareholders).
- The shares may be bearer shares and consequently easily transferred. They can also be personal/registered shares, meaning that they are issued to the name of the shareholder, which is registered at a special book of the company and therefore any new shareholder is registered accordingly.
- The nominal value of each share must be more than €0.30 and less than €100. The shares may have different values (however they must be issued on different stages). Furthermore, the shares can also be issued above par (meaning that the real value is higher than the nominal and in such a case only the nominal value is counted for the share capital and the difference is transferred to a specific reserve). Moreover, if the S.A. is listed, the market value of the share is defined by the stock exchange market.
- The shareholders do not become merchants by participating to the company.
- If the company goes bankrupt the shareholders do not go bankrupt as well.

- The S.A. is the only type of company that can be listed (provided that it meets the legal requirements to enter into the stock exchange market).

- Shareholder's agreements are common, however they bind only the parties of the agreement and not third parties, nor can be used to circumvent mandatory provisions of the law (e.g. the shareholders may conclude an agreement that provides the obligation of the parties to vote to a specific direction. However, if a shareholder in breach of the agreement votes at the General assembly differently, its vote is valid, although it will be liable to pay damages- or any other remedy provided in the agreement- to the other parties).

### 1.2.2 The Private Company (P.C.)

- The capital can be even zero.
- The contributions of the partners can be: **1)** in capital i.e. in cash or in kind (e.g. contribution of a real estate property) and/or **2)** non-capital (e.g. personal labour) and/or **3)** guarantees (by providing a personal guarantee up to an amount for liabilities of the company).
- The partners do not have personal liability for the liabilities of the company.
- The default rule is that the portions are transferable (however, the P.C. cannot issue shares/stocks).
- The partners do not become merchants by participating to the company.
- If the company goes bankrupt the partners do not go bankrupt as well.
- There is no legal requirement for the "real" seat of the company to be in Greece. It is sufficient for the statutory seat to be in Greece.



- The names of the partners are mandatorily published at the company's website.
- The articles of association, their amendments and the decisions of the partners may be drafted in any EU language and registered as such in the General Commercial Registry, provided that they are accompanied with an official translation in Greek.

### **1.2.3 The Limited Liability Company**

- The most distinct characteristic of the Ltd is the dual majority (of capital and of persons) requirement for a decision of the Assembly. A decision must be made by the majority of more than the 1/2 of the number of partners, who represent more than the 1/2 of the capital. One of the two required majorities is not sufficient for a valid decision (e.g. if there are 3 partners, with percentages 70%, 20% and 10% of the capital respectively, the partner with the 70% cannot decide alone in the assembly as there will be a majority of capital but not of persons).
- The contributions of the partners can be in cash and in kind.
- The partners do not have personal liability for the liabilities of the company.
- The default rule is that the portions are transferable (however, as in the P.C., the Ltd cannot issue shares/stocks). The articles of association can include restrictions in transferring the portions.
- The transfer of portions is done by following specific form requirements (a notarial deed which mentions the personal data of the new partners).
- The partners do not become merchants by participating to the company.

- If the company goes bankrupt the partners do not go bankrupt as well.

- The names, the percentages and other personal data of the partners are included in the articles of association which are registered at the General Commercial Registry and uploaded at its site.

- An Ltd may not have as a single partner another Ltd with a single partner. Furthermore, the same person may not be a single partner to more than one Ltds.

### **1.2.4 The General Partnership and the Limited Partnership**

- The general partners have unlimited liability and they are jointly and separately liable for the liabilities of the company. Their liability against third parties cannot be excluded by the articles of association.
- Any new partner is liable for the liabilities of the partnership that arose before joining to the partnership.
- If the partnership is terminated, the partners continue to be liable for the liabilities of the partnership (however, there is a five-year time bar).
- The default rule is that the participation in the partnership is not transferable, however the partners may decide otherwise.
- The partners become merchants (provided that the company is considered as commercial as well) and if the company goes bankrupt, the general partners go bankrupt as well (but not vice versa).
- The personal data of the partners and those who have the power of administration are registered at the General Commercial Registry and uploaded at its site.

## 2. Steps and Timing to Establish

All the above types of companies/partnerships are established in Greece via a One-Stop-Shop. The documentation needed (e.g. articles of association, power of attorney to a representative to proceed with the required procedures before the One-Stop-Shop, passports of the founders, application for the issuance of a Greek tax number etc.) is handed to the competent One-Stop-Shop and subsequently, the latter proceeds with the necessary actions for the establishment of the company (inter alia it receives and examines all the essential documentation; checks for any pre-existing similar trade name; proceeds with the issuing of a Greek Tax Number to the founders (if needed); collects the duty for the incorporation; registers the data of the company to the General Commercial Registry; proceeds with the issuing of a Greek Tax Number to the company; issues a certificate of registration of the company).

On one hand, for the S.A. and the Ltd, the competent One-Stop-Shop is a notary public, and the articles of association must be drafted in the form of a notarial deed. On the other hand, for the P.C., the General Partnership and the Limited Partnership, the competent One-Stop-Shop is the General Commercial Registry (however, if there is any contribution of a real estate property to the company, the articles of association must be in the form of a notarial deed).

Generally, the procedure of establishing the company is rather quick.

Recently, the law 4441/2016 provided a procedure of electronic establishment of companies with the use of template articles of association, however these provisions are not yet in force.

## 3. Governance, Regulation, and Ongoing Maintenance

### 3.1 Brief summary of regulation of each type and ongoing maintenance, reporting requirements

#### 3.1.1 The Société Anonyme (S.A.)

The S.A. is governed by the law 2190/1920 and the articles of association and the main governing bodies are the Board of Directors and the General Assembly.

The S.A. is administered and represented by the Board of Directors, which consists of at least three members, natural or legal persons, Greek or not. The maximum tenure of the Board of Directors is six years.

The supreme body is the General Assembly of the shareholders. The General Assembly has the exclusive authority to decide on several issues of major importance (such as the amendment of the articles of association, the appointment of the directors, the approval of the financial statements, the distribution of profits, the appointment of the auditors, the discharge of the directors from any liability, any merger or transformation of the company and the appointment of the liquidators). In the General Assembly, each share has one vote and the decisions are made by majority. However, for issues of utmost importance (such as the change of the company's nationality or purpose, the increase of the obligations of the shareholders etc.) there is a requirement of an attendance of the shareholders with shares representing the 2/3 of the share capital and a majority of the 2/3 of the share capital.

The General Assembly is convened by the Board of Directors at least once per year, to approve the financial statements of the

company (balance sheet etc.), discharge the Board of Directors from any liability and elect auditors. Subsequently, the financial statements and the decision of the General Assembly must be registered at the General Commercial Registry.

The S.A. must register several data at the General Commercial Registry. These can be data of the company such as name, address, tax number, commercial registry number, the legal representation of the company and the data of the legal representatives, the annual financial statements of the company, the articles of association and their amendments, decision of the Board of Directors for the convocation of the General Assembly etc., which are uploaded to the Registry's website and are accessible to the public.

There is also a (limited) supervision from the State (via the competent Prefecture of the seat of the company and the General Commercial Registry) on several issues, to ensure the legitimacy of the actions of the company in relation to the law, the articles of association and the decisions of the General Assembly. The degree of supervision may vary for several types of S.A., such as the listed S.A.s or those providing banking services.

### **3.1.2 The Private Company (P.C.)**

The company is administered and represented by one or more directors, who can only be natural persons, partners or not (however, if there is no appointment of directors, the company is administered and represented by the partners collectively). The directors may be appointed even for indefinite time. Their appointment is registered at the General Commercial Registry.

The supreme governing body is the Assembly of the partners. The Assembly has the exclusive authority to decide on several issues of major importance (the appointment of the directors, the approval of the financial statements, the distribution of profits, the appointment of an auditor, the discharge of the directors from any liability, the amendments of the articles of association, the exclusion of a partner, the termination of the company or the extension of its duration and any merger or transformation of the company- for the last four a majority of 2/3 is required). In the Assembly, each portion of participation has one vote and the decisions are made by majority. However, the partners can make decisions in writing, without convocation of the Assembly, provided that the decisions are unanimous or that the partners have agreed to the decision in writing without an Assembly. In the latter case, both the majority and the minority votes must be mentioned on the decision. Furthermore, the signatures of the partners may be provided by e-mails or other electronic means, if the articles of association have a relevant provision.

The Assembly can be gathered anywhere and it is convened at least once per year, to approve the financial statements. Subsequently, the decision and the financial statements must be registered at the General Commercial Registry and the latter will be accessible to the public.

The P.C. has the obligation to maintain a website which mentions: the company's capital, the amount of the guarantee contributions, the names and addresses of the partners, the type of their contribution



and the director(s). The website is registered at the General Commercial Registry.

The company must register several data at the General Commercial Registry, such as name, address, tax number, commercial registry number, the legal representation of the company and the data of the legal representatives, any change in the guarantees of the partners, the annual financial statements of the company, the articles of association and their amendments etc., which are uploaded to the Registry's website and are accessible to the public.

### **3.1.3 The Limited Liability Company (Ltd)**

The Ltd is administered and represented by one or more directors, natural or legal persons, partners or not, Greeks or not. If no directors have been appointed, the company is administered and represented by the partners collectively.

There supreme governing body is the Assembly of the partners. As with the other capital companies, the Assembly has the exclusive authority to decide on several important issues, such as the amendment of the articles of association, the appointment/discharge from liability/replacement of the directors, the approval of the financial statements and the distribution of profits, the appointment of the auditors, any actions against the directors and/or any partner, any merger or transformation of the company and the appointment of liquidators. Furthermore, unanimous decision is required for changing the company's nationality and, in principle, for increasing the liabilities of the partners or decreasing their rights.

In the Assembly, each portion has one vote and the decisions are made by the dual

majority of capital and persons, as above mentioned.

As with the other companies, the Assembly is convened at least once per year, to approve the financial statements and the decision and the financial statements are registered at the General Commercial Registry.

The Ltd must register several data at the General Commercial Registry, such as name, address, tax number, commercial registry number, the legal representation of the company and the data of the legal representatives, the annual financial statements of the company, the articles of association and their amendments etc., which are uploaded to the Registry's website and are accessible to the public.

### **3.1.4 The General Partnership and the Limited Partnership**

At the Partnerships, each general partner administers and represents separately the company, even without the consent of the other partners (unless otherwise provided by the articles of association). The above administration refers to the day-to-day management. For any additional action (e.g. amendment of the articles of association, establishment of a branch or sale of important company assets) the consent of all the partners is required (even of those who are excluded by the administration). The same applies for any action that lies out of the purpose of the company. Although the above decisions must be unanimous, the articles of association can provide that a majority is sufficient.

### **3.1.5 Audit Requirements**

The Audit of the financial statements of the companies may be mandatory or non-



mandatory. The Greek law distinguishes the business entities, based on their size, into: **i)** “very small entities”: **a.** total equity ≤ €350,000, **b.** net turnover ≤ €700,000, **c.** personnel ≤ 10 (2 out of 3 criteria are sufficient). The Partnerships are considered very small even if only their net turnover ≤ €1,500,000; **ii)** “small entities”: **a.** total equity ≤ €4,000,000, **b.** net turnover ≤ €8,000,000, **c.** personnel ≤ 50 (2 out of 3 criteria are sufficient); **iii)** “medium entities”: **a.** total equity ≤ €20,000,000, **b.** net turnover ≤ €40,000,000, **c.** personnel ≤ 250 (2 out of 3 criteria are sufficient); **iv)** “big entities”: **a.** total equity > €20,000,000, **b.** net turnover > €40,000,000, **c.** personnel > 250 (2 out of 3 criteria are sufficient).

The annual audit of the financial statements is mandatory for the Partnerships when all the partners are legal entities with limited liability (e.g. S.A, P.C, Ltd), the S.A., the P.C. and the Ltd, provided that they are considered either Medium or Big Entities. The audit of the financial statements constitutes a prerequisite for the financial statements to be approved from the (General) Assembly.

The Small Entities may (non-mandatorily) include a provision for audit at their articles of association or it can be provided by a decision of the (General) Assembly.

Furthermore, the requirements regarding the form/content of the financial statements differs depending on the size of the business entity.

### 3.1.6 Tax Obligations

All the above-mentioned business entities have several obligations to the Tax Authorities. The major is the submission of an income tax return/declaration annually

and the submission of a tax return/declaration regarding the VAT (the latter is submitted periodically, during the year).

The annual profits of the companies (after the deductions of expenses etc. that are provided by the law) are taxed with a rate of 29%.

### 3.2 Requirements for local shareholding/directors

For all the above company types, there are no nationality requirements for the shareholders/partners and the directors.

### 3.3 Minority shareholders' rights and protection

#### 3.3.1 The Société Anonyme (S.A.)

The main minority shareholders' rights at the S.A. are the following:

- The shareholder(s) with shares representing the 1/20 of the share capital may: **i)** demand from the Board of Directors the convocation of the General Assembly and if it does not comply within 20 days, they have the right to do it themselves; **ii)** demand from the Board of Directors to include in the agenda of the General Assembly additional issues; **iii)** demand from and the President of the General Assembly is obliged to adjourn the General Assembly (this right is exercised once per General Assembly); **iv)** demand from the Board of Directors to disclose to the General Assembly the amounts paid during the last two years to the members of the Board of Directors or the managers and any other contract between the company and these persons.

- The shareholder(s) with shares representing the 1/10 of the share capital



may: **i)** demand from the Board of Directors to file a claim against any member of the Board of Directors regarding the administration of the company's affairs. Furthermore, the company may settle any claim against any member of the Board of Directors unless there is an opposition of the shareholder(s) representing the 1/5 of the share capital; **ii)** apply before a Court to order the termination of the company for specific reasons mentioned in the law. The 1/3 has also that right if there is any other serious reason that dictates the termination of the company.

- The shareholder(s) with shares representing the 1/20 or 1/5 (under specific conditions) of the share capital may apply to a Court to order audit of the company.

- Each shareholder may demand from the Board of Directors to provide to the General Assembly information which is material to the agenda.

- The shareholder(s) with shares representing the 1/5 of the share capital may demand from the Board of Directors to provide to the General Assembly information about the company's affairs and its financial situation.

- No permission to provide the company any member of the Board of Directors with any guarantee or other security may be given if there is an opposition of the shareholder(s) with shares representing the 1/10 of the share capital (or 1/20 if the company is listed). Permit for any contract between the company and relatives of the members of the Board of Directors cannot be given if there is an opposition of the shareholder(s) with shares representing the 1/3 of the share capital.

- The shareholder(s) with shares representing the 2% of the share capital may apply before a Court for the annulment of a decision of the General Assembly.

- "Sell Out": The minority shareholders may, under specific circumstances that make their remaining in the company unbearable, apply before a Court to order the purchase of their shares by the S.A. Furthermore, if there is a shareholder whose shares represent at least the 95% of the share capital, the minority shareholders may apply before a Court to order the purchase of their shares by the former (conversely, the shareholder of at least 95% has the right to apply before a Court to oblige the minority shareholders to sell him their shares- "squeeze-out").

### **3.3.2 The Private Company (P.C.)**

- In principle, all the portions of participation confer equal rights and responsibilities regardless the type of the contribution.

- The partner(s) holding the 1/10 of the portions may: **i)** demand from the director the convocation of the Assembly and if he does not comply within 10 days, they have the right to do it themselves; **ii)** request from the court to appoint an independent auditor if there are serious doubts of violation of the law or the statute and report to the partners.

- Each partner has the right: **i)** to be informed about the company's affairs and to examine the books and the documents of the company; **ii)** to demand for information which is essential for the understanding and assessment of the agenda of the Assembly.

### 3.3.3 The Limited Liability Company (Ltd)

The law governing the Ltd focuses more on attributing personal rights to the partners than minority rights.

- First, the minority may be protected by the requirement of the double majority needed for the decisions of the Assembly (both in capital and in persons).

- Some of the rights that each partner has are: **i)** right of administration and representation of the company (if no directors are appointed); **ii)** right to attend and vote to the Assembly; **iii)** to apply before a court for the convocation of the Assembly under specific circumstances; **iv)** to be informed about the progress of the company's affairs and examine the books and the documents of the company and take photocopies of some of them (this right cannot be excluded by the articles of association); **v)** to receive dividends; **vi)** to apply before a court in order to exclude another partner from the company for a serious reason; **vii)** if a partner leaves the company, it has the right to claim the amount of its contribution as a refund; **viii)** the pre-emptive right for purchasing portions in case of an increase of capital. This right also exists regarding the purchase of the portions of a deceased partner from its heir; **ix)** to apply before a court for the replacement of the director for a serious reason; **x)** to apply before a court for the annulment of a decision of the Assembly; **xi)** to apply before a court for the termination of the company under several circumstances.

- Partner(s) whose portions represent: **i)** the 1/20 of the capital may demand from the director(s) the convocation of the Assembly or else they may apply to a court to that end;

**ii)** the 1/10 of the capital may apply before a court for the termination of the company for a serious reason.

### 3.3.4 The General Partnership and the Limited Partnership

- The general partners have the right to oppose to any action of administration (before it is performed). The opposition does not affect the validity of that action; however, the administrator may be held liable for exceeding its administrative powers.

- The partner(s) who administrate(s) the company has the obligation to inform the other partners about the company's affairs and give account to the other partners.

- The limited partners have the right to examine the company's accounts and books. They also receive dividends.

## 4. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions

### 4.1 Any significant barriers to entry for an offshore party

There are no significant barriers for an offshore party to be a partner/shareholder of the above company types.

### 4.2 Capitalisation obligations

#### 4.2.1 Capital requirements

##### 4.2.1.1 The Société Anonyme (S.A.)

The minimum share capital is €24,000. However, the minimum capital may be higher for several types of undertakings (e.g. banking services) or to be listed in the stock exchange market.

If the amount of the total shareholders equity becomes less than the 1/2 of the share capital, the General Assembly must

decide for any adequate remedy or to terminate the company. If the total shareholders equity becomes less than the 1/10 of the share capital the court may decide for the termination of the company.

If there is no sufficient funding for the purposes of the company, it may be assessed by a court as one of the criteria for deciding the “lift of the corporate veil” and consequently personal responsibility of the shareholder(s).

#### **4.2.1.2 The Private Company (P.C.)**

In the P.C. there is no minimum capital requirement. It can be even zero. The share capital is calculated only based on the contributions in capital (in cash or in kind) and not the non-capital contributions and the guarantees.

#### **4.2.1.3 The Limited Liability Company (Ltd)**

In the Ltd there is no minimum capital requirement.

If the equity of the company is reduced to 1/2, the Assembly must decide the reduction of the capital or the termination of the company, or else whoever has a legal interest may apply to the court for the termination of the company.

If the partners have provided loans to the company and the equity of the company is not sufficient for the satisfaction of the rest of the company’s debtors, then the amount of the loans is not returnable to the partners.

#### **4.2.1.4 The General Partnership and the Limited Partnership**

In the General Partnership and the Limited Partnership there are no capital requirements, as the general partners have unlimited personal responsibility.

#### **4.2.2 Thin Capitalisation Rules**

The Greek Income Tax Code provides thin capitalisation rules, according to which, in principle, only the amount of interest that does not exceed the 30% of the taxable EBITDA is tax deductible as business expenses. However, they are tax deductible, if the annual net amount of interest does not exceed €3,000,000.

#### **4.3 Any special business or investment visa issues**

Residence permit requirements: Non-Greek or non-EU nationals can be partners/shareholders of all the types of companies, without any residence permit requirements, apart from the general partners of the Partnerships, for whom a residence permit for independent work is required. On the other hand, there is a need for a residence permit for independent work for the directors of the P.C. and the Ltd and for the legal representatives of the S.A.

Business and Investment Residence Permit: In the Greek law, a residence permit may be issued inter alia for the following Non-Greek or non-EU nationals:

i) Members of the board of directors, shareholders, directors, legal representatives, and high ranked personnel (general managers, managers) of Greek companies (provided that the Greek company has minimum personnel of 25 persons) and of subsidiaries and branches of foreign companies; ii) Individuals that will proceed with an investment in Greece that is considered to have positive consequences to the growth of Greece. Depending on the amount of the investment up to 10 individuals can receive the present residence permit.



#### 4.4 Any restrictions on remitting funds out of the jurisdictions (withholdings, etc.)

##### 4.4.1 Withholdings

Dividends: According to the Greek Code of Income Tax the dividends are taxed with a tax rate of 15%. The amount of tax is withheld by the company. As “dividends” are considered: any income from shares, founder’s shares, or other rights of participation in the profits, which do not constitute claims from debts, and the income from any other company rights, including shares (quoted or unquoted), interim dividends and mathematical reserves, equity stakes, distribution of profits from any legal person or legal entity and any other relevant distributed amount.

However, the dividends which are distributed within the same Group and are received by a Greek or an EU company resided in Greece are tax exempted if the legal entity that distributes them: **i)** is of the type that is included in the Directive 2011/96/EU; **ii)** it is resident of an EU

member state; **iii)** it is subject to the taxes mentioned the Directive 2011/96/EU; **iv)** the receiver has a minimum participation of 10% of the capital of the legal entity that distributes and **v)** the minimum participation is kept for at least 24 months.

It must be noted that Greece have signed conventions for the avoidance of double taxation with 57 countries that include also the issue of the taxation of dividends and the withholdings.

##### 4.4.2 Capital Controls

Since the summer of 2015 capital controls were imposed in the bank transactions in Greece. The capital controls remain until now, but they are reduced progressively. However, it is not clear when they will definitely be lifted.

Regarding any transfer of capital abroad, depending on the amount and the usage, a permit from a special committee may usually be required.





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# INTERNATIONAL LAWYERS NETWORK



**JALSOVSZKY LAW FIRM**  
**ESTABLISHING A BUSINESS ENTITY IN HUNGARY**

**ILN CORPORATE GROUP**



## ESTABLISHING A BUSINESS ENTITY IN HUNGARY

### 1. Introduction

Since 1990, the Hungarian economy is based on the principles of market economy and considers the freedom of economic competition as a priority. On such basis, the regulation of business associations went through significant changes before evolving into its current form in Act V of 2013 on the Civil Code („**Civil Code**”). The current regulations entered into force on 15 March 2014, replacing the provisions of Act IV of 2006 on the business associations. Both pieces of legislation present a set of rules that is reliable and enables market participants to customise their companies to their respective needs.

Generally, the Civil Code allows greater flexibility for the founders of Hungarian companies when determining the contents of the company’s establishing documents. This is so because, as opposed to the compulsory provisions of the previous regulations, deviation is generally allowed from the relevant rules of the Civil Code, subject to certain limitations.

The purpose of this summary is to outline a high-level overview of the main aspects that need to be considered in case of establishing a Hungarian business entity or acquiring a shareholding interest in a Hungarian company.

### 2. Company forms in Hungary

Companies may only be founded in the forms regulated in the Civil Code. The available company forms are the following:

- general partnership (‘*kkt.*’)
- limited partnership (‘*bt.*’)
- limited liability company (‘*kft.*’)
- private company limited by shares (‘*zrt.*’)

While the liability of the members of partnerships for the debts of the company is, in

general, unlimited, the other two company forms offer limited liability to the shareholders. Consequently, in the business practice, the ‘*kft.*’ and the ‘*zrt.*’ forms are the most popular forms of companies.

According to the provisions of the Civil Code, establishing public companies limited by shares (‘*nyrt.*’) upon foundation is no longer possible. Such companies may only be created by the transformation of private companies limited by shares since March 2014.

As the *kft.* and *zrt.* forms are the most commonly used forms of business entities in Hungary, in the forthcoming sections we give a general overview and comparison of these two company types.

### 3. Limited liability companies

#### 3.1 Company name

The designation „*korlátolt felelősségű társaság*” (limited liability company) or its abbreviation „*kft.*” must be indicated in the company’s name.

#### 3.2 Capital requirements

The current minimum amount of the registered capital of a *kft.* is HUF 3,000,000 (approximately EUR 10,000) which can be provided as a cash or as an in-kind contribution. An in-kind contribution may be any marketable thing of value or intellectual work, any intangible property or any claim that is recognised by the debtor or that has been granted by a final and definitive court decision.

The Civil Code has raised the minimum registered capital for limited liability companies from HUF 500,000 (approximately EUR 1,700) to HUF 3,000,000 for creditor protection reasons. This created an obligation for already operating limited liability



companies to resolve on the increase of their registered capital not later than 15 March 2017.

The contribution of each member may not be less than HUF 100,000 (approximately HUF 340). The Civil Code supersedes the previous regulation thus the contribution may not necessarily be divisible with HUF 10,000 since March 2014.

### 3.3 Membership rights

The membership rights in limited liability companies are represented by so-called „business quotas”. The business quota is a notional concept as it is not embodied in physical or electronic form, but is solely registered in the members’ list of the company. The business quota represents membership rights and obligations of each member of the company.

Each quotaholder has one business quota. The size of the business quotas of the different members can, however, be different. Furthermore, one business quota may be held by more than one quotaholder. In such case, it is considered as a joint business quota and the relating rights may be exercised by the joint representative of the quotaholders.

If not provided otherwise, the extent of voting rights, rights to dividend and other membership rights are linked to the capital contribution made by the respective quotaholder.

### 3.4 Special rights

Special rights can be attached to the business quota of any of the quotaholders. Such special right can, for instance, offer the quotaholder voting preference, dividend preference, liquidation proceed preference or other preferences relating to the transfer of business quotas. There are no limitations or restrictions on the extent of such special

rights, they are merely subject to the agreement of the quotaholders.

### 3.5 Transfer of ownership rights

Business quotas are freely transferable among the members of the company. However, the members may decide on various restrictions relating to the transferability of the business quotas to third parties, such as pre-emption rights or the requirement for the members’ meeting’s consent.

Business quotas may be transferred via a written contract between the seller and the purchaser. The purchase of the business quota must be notified to the managing director of the company which, upon such notification, register the new quotaholder in the members’ list of the company.

### 3.6 Supreme body

The supreme body of the limited liability company is called the members’ meeting which must be convened by the managing director.

The members’ meeting has a quorum if at least half of the eligible votes are represented. If the articles of association permit so, the members’ meeting may be held by electronic means of communication. The decisions falling within the scope of the members’ meeting may also be made in a written form, without holding a meeting.

Generally, the decisions of the members’ meeting are passed with simple majority of votes, although the Civil Code also requires that certain strategic decisions must be resolved with a qualified (75%) majority. The members may adopt higher majority requirements for certain decisions in the articles of association of the company.



### 3.7 Executive officers

The executive officers of a kft. are called managing directors. The managing directors are, generally, elected by the members' meeting. The current regulations enable the companies to decide whether the managing directors should act individually concerning the operative day-to-day decisions of the company or to form a body of the managing directors. The Civil Code also allows legal entities and not just natural persons to be elected as managing directors.

### 3.8 Supervisory board

The election of a supervisory board is only mandatory if the number of full-time employees of the limited liability company exceeds 200 on annual average.

### 3.9 Auditor

The appointment of an auditor is only mandatory if the company's yearly revenues exceed HUF 300 million or the company employs more than 50 employees.

The auditor is elected by the supreme body of the company.

## 4. Private companies limited by shares (zrt.)

### 4.1 Company name

The designation „zártkörűen működő részvénytársaság” (private company limited by shares) or its abbreviation „zrt.” must be indicated in the company's name.

### 4.2 Capital requirements

The minimum amount of the registered capital is HUF 5,000,000 (approximately EUR 17,000) which can be provided as a cash or as an in-kind contribution. An in-kind contribution may be any marketable thing of value or intellectual work, any intangible property or any claim that is recognised by

the debtor or that has been granted by a final and definitive court decision.

There are no restrictions on the nominal value of the shares.

### 4.3 Membership rights

The membership rights in a zrt. are represented by shares. The shares are considered as securities and may exist in physical (printed) or in dematerialised form. In the latter case shares are recorded on the securities account of the shareholder.

If not provided otherwise, the extent of voting rights, rights to dividend and other shareholder's rights are linked to the nominal value of the share.

### 4.4 Special rights

Preferred shares may be issued by the company to its shareholders. The total nominal value of the preferred shares may currently not exceed 50% of the capital of the company. The Civil Code does not set out such an exhaustive list of preferential rights, enabling the shareholders to resolve on issuing preferred shares with any desired preferential rights, without any restriction.

In addition to preferred shares, other special types of shares (e.g. employee shares, interest bearing shares, redeemable shares, etc.) may be issued by the company.

### 4.5 Transfer of ownership rights

Shares are freely transferable; however certain restrictions may be imposed on the transferability of the shares by the shareholders. Such restrictions are only valid if indicated on the share certificate itself.

Physical shares may be transferred by physical delivery, together with a written endorsement.





Dematerialised shares are transferred via debiting and crediting the securities accounts of the respective shareholders.

#### 4.6 Supreme body

The supreme body of a private company limited by shares is the general meeting which is convened by the board of directors or the chief executive officer.

The general meeting has a quorum if at least half of the eligible votes are represented. If the statutes permit so, the general meeting may be held by electronic means of communication. The decisions falling within the scope of the general meeting may also be made in a written form, without holding a meeting.

Generally, the decisions of the general meeting are passed with simple majority, although the Civil Code require that certain strategic decisions must be resolved with qualified (75%) majority. The shareholders may stipulate higher majority requirements for certain decisions in the statutes.

#### 4.7 Executive officers

The executive body of a private company limited by shares is its board of directors which consists of a minimum of three natural person members.

If the statutes so provide, the company can elect a single chief executive officer instead of a board of directors.

#### 4.8 Supervisory board

The election of a supervisory board is only mandatory if it is requested by the shareholders controlling at least five per cent of the total votes or if the number of full-time employees of the company exceeds 200 on annual average.

#### 4.9 Auditor

The appointment of an auditor is only mandatory if the company's yearly revenues exceed HUF 300 million or the company employs more than 50 employees.

The auditor is elected by the supreme body of the company.

### 5. Documentation for company establishment

In this section, we give a practical overview of the required documents for the incorporation of a company in Hungary.

**5.1 Documents prepared by legal counsel and to be signed by the founders or the executive officers of the companies are:**

- constitutive document (Articles of association / Statutes / Deed of foundation – depending on the respective company form);
- power of attorney given to the attorney representing the company in the court of registration procedure (this is an obligatory document as the company must be represented by an attorney or a legal counsel during the court of registration procedure);
- declaration of acceptance of the executive officers / supervisory board members / auditor (the appointments will only become effective if the elected persons declare their acceptance);
- specimen signature of the persons signing on behalf of the company;
- in case of a limited liability company: a members' list indicating the members / quotaholders of the company and limitations on the transfer of the business quotas; and
- other ancillary documents set forth by laws.





**5.2 Documents to be provided by the founders are:**

- in case the founder of the company is a foreign entity: the certificate of incorporation of the founder (such certificate must not be older than 3 months and signing authority on behalf of the entity must be apparent from it) and its official translation;
- declaration of the executive officer or documentary evidence on the valid use of the registered seat / branch office of the company;
- verification of payment of the registered capital of the company – a bank certificate or the declaration of the executive officer of the company on the payment of the contributions; and
- tax identification number of the quotaholders / shareholders and the executive officers – if individuals are reluctant to provide their home tax number, a Hungarian tax number can be obtained.

5.3 Furthermore, the verification on the payment of the obligatory procedural duty and the publication fee shall also be submitted to the Court of Registry. Starting from March 2017, however, the establishment of a kft has become free of procedural duty enabling founders an even more cost-effective way to establish Hungarian companies.

## **6. The establishment process**

A company is considered as formed, if it is entered into the register of companies. The date of incorporation of the company is considered to be the date when the registration takes place. The company may start its operations as a „pre-company” as of the date of the countersignature of its constitutive document and engage in business operations after having received its tax identification code.

A simplified registration procedure may be applied, if the company’s constitutive document is based on a standard form prescribed by the laws. The use of standard forms provides less flexibility but leads to lower registration fees and quicker registration.

An estimated timeline of a company registration is the following:

- i. day 0: all the required information on the company given to the attorney;
- ii. between day 0 and day 4: preparation of the required documents by the attorney;
- iii. between day 4 and day 11: signing of the documents by the founders and executive officers; it is to be noted that some of the documents need to be notarised and apostilled (or attested by the Hungarian consulate) if signed outside Hungary;
- iv. day 11: countersignature by the attorney;
- v. day 12: filing the application with the competent Court of Registration;
- vi. day 15: receipt of VAT number of the company; and
- vii. between day 16 and day 30: registration of the company by the Court; it must be noted that the Court shall register the company within 1 business day of the receipt of its VAT number in case of a simplified procedure.

## **7. Governance, Regulation, and Ongoing Maintenance**

### **7.1 Accounting requirements**

The companies incorporated in Hungary need to comply with various Hungarian accounting and filing requirements.

The Hungarian accounting rules are in line with EU and International Accounting Standards. Double-entry bookkeeping is required for limited liability companies and for companies limited by shares.



Act C of 2000 on accounting regulates the accounting, audit and reporting requirements and contains the rules for the financial statements to be prepared by the companies.

The company needs to keep an on-going record on its financial status during the financial year. The company must consider the basic principles of accounting when preparing its records. Such basic principles contain rules for the invoices and accounting documents issued or received and the method of the accounting.

### **7.2 Reporting requirements**

The company needs to prepare at the end of each financial year a financial statement. A company is entitled to prepare and submit a simplified financial statement if two of the three following conditions can be applied to the company: (i) the company's balance sheet total does not exceed HUF 1,200 million (approximately EUR 3,871,000), (ii) its annual net turnover does not exceed HUF 2,400 million (approximately EUR 7,742,000) and (iii) the company employs less than 50 employees in average. Companies not fulfilling the above requirements need to prepare and submit a business report in addition.

Companies considered to be parent companies are required to prepare and submit consolidated reports.

The companies' financial statements need to be uploaded to the Electronic Financial Statement Website and these documents are available to the general public.

### **7.3 Audit requirements**

The appointment of an auditor is only mandatory if the company's yearly revenues exceed HUF 300 million or the company employs more than 50 employees.

### **7.4 Registers**

Hungarian companies need to maintain different registers themselves, e.g. register of the company's members.

### **7.5 Annual return**

Hungarian companies need to submit concerning each financial year an annual return.

### **7.6 Requirements for local shareholding/directors**

There are no requirements for local shareholding or directors, but in regulated sectors some restrictions may apply.

### **7.7 Minority shareholders' rights and protection**

The protection of minority interests is guaranteed in the Civil Code.

The members (shareholders) of a company having at least 5% of the voting rights can request that the meeting of the supreme body is convened. If the executive body does not comply with such request, the minority can enforce its right in the court.

Minority shareholders has various additional protective rights, such as they can request that an auditor examines the last financial statement of the company or a given act of the executive officers of the company from the last two years. Also, minority shareholders can enforce the claim of the company against its members (shareholders), executive officers, supervisory board members or the appointed auditor of the company if the supreme body of the company decided not to do so, or the supreme body did not decide on this point even though it was on the agenda of the meeting.



## 8. Foreign Investment, Thin Capitalisation, Residency and Material Visa Requirements

### 8.1 Any significant barriers to entry for an offshore company

There are no general barriers to entry for offshore companies. Restrictions may apply in the sectors where a permit for the beginning of the company's activity is required.

### 8.2 Any capitalisation obligations

The capital requirements for the limited liability company are set out under Section 3.2 of this summary and the capital requirement for private companies limited by shares are set out under Section 4.2.

In case the company does not fulfil according to its balance sheet data the minimum capital requirement determined for its company form in two successive financial years, then the supreme body of the company needs to decide either on the provision of the necessary capital or the reorganisation to another company form.

### 8.3 Any special business or investment visa issues

The citizens of the European Economic Area countries do not need any permit to live and work in Hungary. Some restrictions may apply to employees from Romania, Bulgaria, or Croatia. Third country citizens need to apply for a residence permit and a work permit to live and work in Hungary.

A third country citizen may apply for a Hungarian residence permit for maximum 5 years if he/she can prove to own, or if a company in his/her majority ownership owns treasury bonds of a nominal value of at least EUR 250,000 specifically issued by the Hungarian State for this purpose.

### 8.4 Any restrictions on remitting funds out of the jurisdiction

Hungary does not levy withholding tax on dividend payments made to non-resident enterprises.

## 9. Our firm

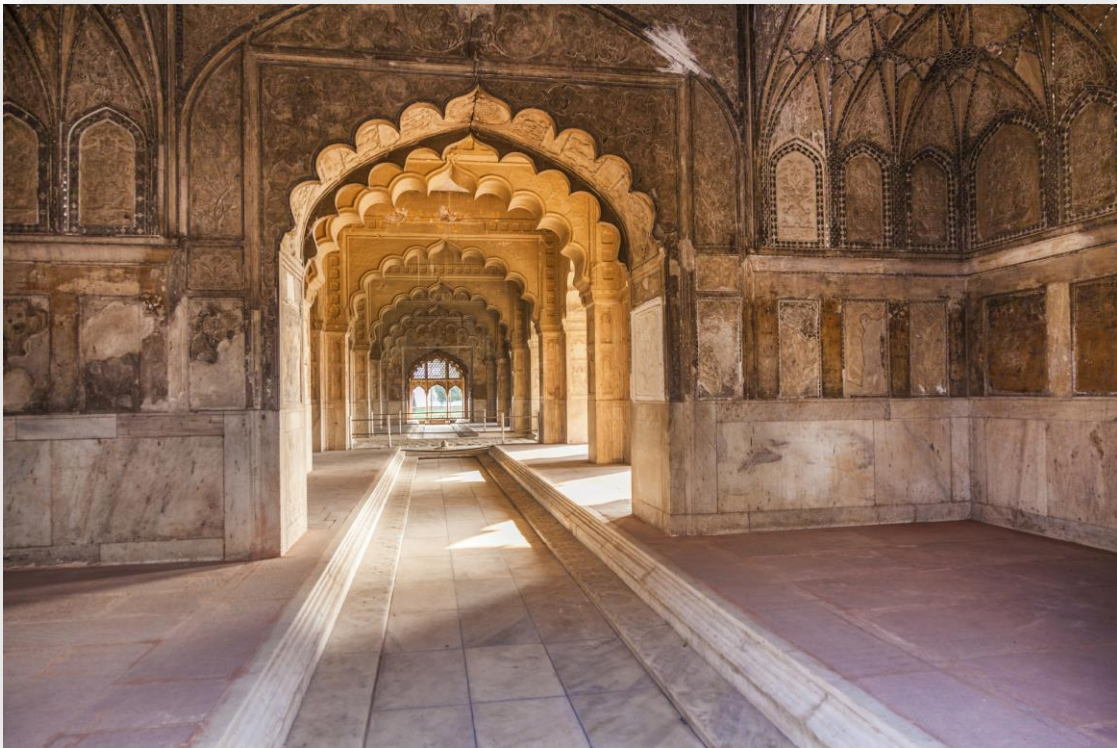
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# INTERNATIONAL LAWYERS NETWORK



**LEXCOUNSEL LAW OFFICES  
ESTABLISHING A BUSINESS ENTITY IN INDIA**



## ESTABLISHING A BUSINESS ENTITY IN INDIA

### 1. Types of Business Entities

#### 1.1 Description of the types of entities available in India through which to conduct business

A foreign entity may establish a business presence in India by:

- opening a liaison office, branch office or project office;
- appointing a distributor or franchisee;
- commencing its own operations in India;
- forming a joint venture with an Indian entity; or
- acquiring an existing business in India.

#### 1.2 Matters to be considered when choosing a particular business entity type

A liaison office can only be established to primarily explore and understand business opportunities and climate in India for the foreign parent entity. A liaison office is not permitted to earn any income in India by conducting any business or commercial activities in India.

A branch office can carry on business activities while a project office can be established to execute a specific project. However, since a branch office or a project office would not be considered a legal entity separate from its parent company, the business income generated by them would be taxable at the rate of tax applicable to foreign companies (40% plus surcharge and cess) which is higher than the rate of tax applicable to companies incorporated in India (30% plus applicable surcharge and cess).

Applications for establishment of a liaison or branch office in India are considered by designated authorized dealer banks (“**AD Bank**”) in accordance with guidelines issued

by Reserve Bank of India (“**RBI**”). However, prior approval of RBI may also be required in certain cases such as where the applicant is a citizen or registered/incorporated in certain notified countries or where the principal business of the applicant falls in certain notified sectors such as defence, telecom etc.

In view of restrictions on the activities and tax implications for liaison, branch and project offices, establishment of a wholly owned subsidiary, or strategic alliances through joint ventures, technical collaborations or distributorship arrangements with existing Indian companies by and large remain the preferred options for foreign entities to establish a long-term presence in India.

### 2. Steps and Timing to Establish

#### 2.1 Brief overview of steps to incorporate/constitute each

Companies incorporated outside India, desirous of opening a Liaison/Branch office in India have to make an application in prescribed form to the AD Bank, along with prescribed documents including the English version of the certificate of incorporation/registration or Memorandum & Articles of Association attested by Indian Embassy/Notary Public in the country of registration and audited balance sheets of the applicant entity for the last few years as prescribed.

Incorporation of a company in India is an administrative process which takes approximately 15 (fifteen) to 20 (twenty) working days from filing of incorporation related documents (“off the shelf” companies are not recommended in view of related due diligence issues and liabilities). The MCA21 e-Governance programme by the Government of India has simplified the entire incorporation process and the process may be completed online. For the purpose of e-filing





forms, a digital signature certificate has to be obtained from the concerned authority without which e-filing cannot be done. The purpose of the digital signature is to ensure the security and authenticity of documents filed electronically. It generally takes only 1 (one) working day for obtaining a digital signature. Also, persons seeking appointment as directors of an Indian company are mandatorily required to obtain director identification number (“DIN”) without which such appointment would be invalid. Allotment of DIN takes approximately 3 (three) to 4 (four) working days. The DIN is specific to each individual and there is no requirement of a fresh DIN for appointment as a director of other Indian company/ies. A company incorporated anywhere in India is entitled to carry on business activities throughout India.

Joint ventures other than by way of incorporating a new company (i.e. other than by way of investment in a new company jointly with the Indian partner) may be formalized by way of a simple transfer of shares. However, transfer of shares between Resident and Non-Resident need reporting to the RBI. Further, depending on the percentage of foreign direct investment contemplated, prior approval of the concerned ministry/department may be required if the business of the new company falls in a sector, where 100% foreign direct investment is not permitted under the automatic route (i.e. without prior government approval).

Other contractual arrangements such as distributorship/franchise agreements or trademark/brand licensing agreements etc., for doing business in India can be formalized in 1 (one) to 2 (two) days, except where sector specific licenses are involved. India does not have any standard regulations for

protection of franchisees, and thus the relationships are broadly governed by the contracts between the parties.

### 3. Governance, Regulation, and Ongoing Maintenance

#### 3.1 Brief summary of regulation of each type and ongoing maintenance, reporting requirements

Primary regulations under Indian laws:

- i. Companies Act, 2013;
- ii. Foreign Exchange Management Act, 1999 and RBI regulations governing establishment and operations of Branch Office/Liaison Office/Project Office (as updated from time to time);
- iii. Income Tax Act, 1961; and
- iv. In addition, an Indian company would also require obtaining common licenses and registrations, such as Goods and Services Tax registration.

#### 3.2 Immediate Requirement: Setting Up – Compliances usually on-going/time based:

- A. Under the Income Tax Act, 1961, every entity is required to have a Permanent Account Number (“PAN”), Tax Deduction and Collection Account Number (“TAN”) and deduct tax at source (“TDS”) for all the payments made to its employees at the percentage given under the relevant provisions of the Income Tax Act, 1961.
- B. Board Meetings/Annual General Meeting (“AGM”)/ Resident Director – Every company is mandatorily required to hold 4 (four) Board meetings and 1 (one) AGM in a year. It is also mandatory for every company to have at least 1 (one) resident director.



- C. Every Listed Company /Public Company with paid up capital of Rs 100 Crores (Rupees Hundred Crores) or more / Public Company with turnover of Rs 300 Crores (Rupees Three Hundred Crores) or more shall have at least 1 (one) woman director.
- D. Listed Company are also required to appoint at least 1/3 (One third) of total number of directors on their Board of Directors as independent directors. Further, the certain classes of public companies are also mandated to have at least 2 independent directors.

### 3.3 Filings with the registrar/reporting requirements:

Example:

- A. Annual Filing e-Forms: Form for filing annual return by a company having a share capital, particulars of annual return for the company not having share capital, form for filing balance sheet and other documents, form for filing Profit and Loss account and other documents, form for submission of compliance certificate have to be filed with the concerned Registrar of Companies annually;
- B. Return of Particulars of Directors and Key-Manual Personnel's ("KMP") – Return containing such particulars and documents of the director and other KMP shall be filed with the Registrar within 30 (thirty) days from the date of appointment/resignation of every director and KMP and also within 30 (thirty) days of any change taking place;
- C. Return of appointment of Managing Director ("MD"), Whole Time Director ("WTD") and Manager – Company is required to file a return within 60 (sixty)

days of the appointment of a MD, WTD or Manager;

- D. Filing of Income Tax returns is required to be done every year by the entity operating in India in addition to the TDS return which is also required to be submitted with the tax authorities annually.

Relatively, the operational on-going and maintenance requirements with respect to companies incorporated under Indian laws are quantifiably more than Liaison Office/Branch Office/Project Office. That said compliances for companies also defer based on their classifications. For example: Public Limited companies have more compliance in general as compared to Private companies. Small companies and one-person companies do not have so many compliances, as compared the larger/more traditional forms of companies etc.

### 3.4 Requirements for local shareholding/directors

It is mandatory for every company to have at least 1 (one) resident director i.e. a person who has stayed in India for a total period of not less than 182 (one hundred and eighty-two) days in the previous calendar year.

However, there is no such requirement in the case of shareholders, and all the shareholders can be non-resident.

### 3.5 Minority shareholders' rights and protection

Companies Act, 2013 has sought to empower the minority shareholders in many ways including the class action suit. Under the concept of class action suit, a suit may be instituted against the company as well as the auditors of the company by the minority shareholders. Companies Act, 2013 further provides for provisions relating to oppression



and mismanagement which empowers minority shareholders to file an application for relief to the Tribunal in case of oppression and mismanagement. Under Companies Act, 2013, the Tribunal may also waive any or all the requirements given under Companies Act, 2013 and allow any number of shareholders and/or members to apply for relief, though this power to waive is rarely exercised by the Tribunal.

#### 4. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions

##### 4.1 Any significant barriers to entry for an offshore party

The Foreign Exchange Management Act, 1999 and the rules and regulations framed thereunder provide the basic legal framework for foreign investments in India. The RBI together with the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry and various other ministries and departments of the Central Government contribute to framing and modifying sector specific regulatory framework, and are involved in granting of approvals for foreign investments in India depending upon the sector in which the operations of the target entity falls.

##### 4.1.1 Financial Collaboration

In terms of the current Foreign Direct Investment (“FDI”) policy, foreign investment up to 100% (hundred percent) of the securities (including shares and fully and mandatorily convertible preference shares and debentures) of Indian companies is freely permitted in most sectors (“**Unregulated Sectors**”). However:

- Foreign investment beyond prescribed percentages is not permitted without prior government approval in a few sectors/activities, such as insurance,

scheduled/regional air transport services, banking, telecom, defense, and multi-brand retail trading etc. (“**Regulated Sectors**”). A financial collaboration in the Regulated Sectors ordinarily requires presence of an Indian equity partner to hold the remaining equity and compliance with the relevant sectoral conditions on entry route, conditionalities and caps.

- Foreign investment is prohibited in certain sectors including atomic energy, lottery, gambling, trading in transferable development rights, manufacturing of tobacco products or substitutes, railway operations (except for permitted operations), etc.
- FDI in limited liability partnerships (“**LLPs**”) is permitted, subject to certain conditions e.g. the FDI is allowed, under the automatic route, , in LLPs operating in sectors/activities where 100% (hundred percent) FDI is permitted and there are no FDI linked performance conditions. Investment in LLPs either by Foreign Portfolio Investors (“**FPIs**”) or Foreign Venture Capital Investors (“**FVCI**”) is not permitted.
- A foreign investor can without prior government approval invest in unlisted securities of an existing Indian company in Unregulated Sectors, in accordance with the pricing guidelines, and subject to overall compliance with the FDI policy, and accordingly such securities can also be issued/transferred to it by Indian or foreign shareholders.

##### 4.2 Any capitalisation obligations

Presently, there is no requirement for incorporation of companies with any



minimum paid up share capital under the Companies Act, 2013. However, from a foreign investment perspective, any foreign investment beyond prescribed percentages is not permitted without prior government approval in Regulated Sectors. Further, depending upon the sector of investment, there could be certain minimum capitalization norms applicable under the prevailing foreign direct investment policy.

### **4.3 Any special business or investment visa issues**

Foreign nationals are allowed to come to India on business or employment visas, depending on the nature of their deployment and other similar factors.

For reasons of taxation, deputation of employees of foreign parent companies to their Indian subsidiaries is ordinarily avoided.

As per the Ministry of Home Affairs, Government of India latest guidelines, employment visas are only granted to foreign nationals drawing salaries in excess of a prescribed amount per annum. The minimum salary stipulation however does not apply to ethnic cooks, translators and language teachers brought for project related work in India. The employment visa has to be issued from the country of origin or domicile of the foreigner. Foreign nationals may also use the 'Project' visa regime for coming to India for execution of specific projects in the power and steel sectors.

Persons travelling to India on long term employment visas need to register themselves with the jurisdictional Foreigners Regional Registration Office within specified time (ordinarily fourteen days) of arrival in India.

### **4.4 Any restrictions on remitting funds out of India (withholdings, etc.)**

Foreign investors can repatriate funds out of India through a number of options including dividends, fees for technical and administrative services, royalties, interest, capital appreciation, etc., after payment of applicable taxes. India also has double taxation avoidance agreements ("DTAA") with all major economies of the world including Australia, China, Germany, France, Spain, Singapore, USA, UK and Japan to name a few.

#### **4.4.1 Repatriation of Profits**

Indian companies can remit their profits to a foreign collaborator by way of dividends subject to dividend distribution tax @ 17.00% (seventeen percent) approx. excluding applicable surcharge and cess. There is no limit on the rate of dividend on equity shares that can be distributed or repatriated out of India. The rate of dividend on preference shares issued by an Indian company to a foreign collaborator should not exceed 300 (three hundred) basis points over State Bank of India's prime lending rate prevailing on the date of the meeting of the directors of the company in which issue of the preference shares is recommended.

Branch offices of foreign companies can also remit business profits to their principals subject to withholding tax @ 40% (forty percent) plus applicable surcharge and cess (unless lower tax rate is prescribed by the DTAA).

#### **4.4.2 Repatriation of Fees and Royalties**

The royalties/fees for technical services can be remitted to non-residents subject to deduction of withholding tax at prescribed rates. If the foreign collaborator belongs to a country having a DTAA with India, it can avail credit of withholding taxes paid in India.

As discussed above, the lump sum technical know-how fee and/or royalty may also be converted into shares of the Indian company, subject to regulatory compliances.

#### **4.4.3 Capital Gains**

In the absence of stipulation of a lower rate of tax by the DTAA, capital gains can be repatriated out of India subject to withholding tax between 10% (ten percent) to 20% (twenty percent) (plus applicable surcharge and cess), depending on their nature.

#### **4.4.4 Capital Repatriation on Disinvestment**

AD Banks ordinarily allow repatriation of sale proceeds of a security (net of applicable taxes) provided the security is held on repatriation basis and the sale has been made in accordance with prescribed guidelines and tax clearance/'no objection' certificate from Indian tax authorities has been produced. Repatriation may be made through normal banking channels.





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# INTERNATIONAL LAWYERS NETWORK



**HOLMES O'MALLEY SEXTON SOLICITORS  
ESTABLISHING A BUSINESS ENTITY IN IRELAND**

## ESTABLISHING A BUSINESS ENTITY IN IRELAND

### I. Introduction

As a common law jurisdiction, Ireland's legal system is similar to that of the US and the UK and businesses can be carried on in Ireland in several different ways, including as sole traders, partnerships or companies.

#### Companies

A company is a body formed and registered under the Companies Act 2014 which has legal personality separate and distinct from its shareholders. There are various types of companies and each has its own distinct advantages and disadvantages.

#### Sole Traders

A sole trader may be defined simply as an individual who sets him or herself up in business. Sole traders do not enjoy separate legal personality and are therefore liable for any losses accruing to their business. Persons engaged in business as sole traders may protect themselves to some extent from certain categories of loss which the business might incur through the purchase of insurance.

#### Partnerships

The Partnership Act 1890 defines a partnership as a *"relation which subsists between persons carrying on a business in common with a view to profit"*. A "business" is defined in the Partnership Act to include *"every trade, occupation or profession"*.

Essentially, a partnership is the coming together of two or more persons in return for benefits received, such as extra capital and expertise from the others engaged in the venture. Partnerships, in contrast to companies, are not legal entities: there may be a name attached to the partnership but it consists solely of the individual partners and the partnership has no independent legal existence.

The partners share the profits of their venture and, similarly, the assets and liabilities are those of the partners. It is possible to register a limited partnership in which some partners have limited liability under the Limited Partnerships Act 1907 but limited partners may not take place in the management of the business.

Whereas the affairs of a company are managed by its directors (and not by its shareholders), each partner is entitled to participate in all the activities of the partnership.

### II. Types of Companies

All Irish companies are governed by the Companies Act 2014, which came into force on 1 June 2015. There are several different types of company structure provided for under the Companies Act 2014 and companies can be broadly classified as either private or public companies with limited or unlimited liability.

#### Companies Act 2014

The Companies Act 2014 condenses the previous 17 companies acts and related company law provisions into a single comprehensive code of company legislation. The design of the Companies Act 2014 focuses on simplification and modernisation of company law. It created new forms of company and introduced several changes to the roles of various persons in the corporate structure.

A significant portion of the Companies Act 2014 is dedicated entirely to the private company limited by shares (LTD). The LTD is the company model of choice for the vast majority of private companies in Ireland. The remainder of the Companies Act 2014 sets out the law applying to other company types, including designated activity companies (DACs), public limited companies (PLCs), unlimited companies, companies limited by guarantee (CLGs) and external companies.

### 1. Private Company Limited by Shares (LTD)

The LTD is the most common form of company in Ireland. Like other limited companies, including DACs, a principal advantage of LTDs is that the liability of its shareholders is limited to the amount, if any, unpaid on the shares registered in their name.

A key distinction between LTDs and DACs is that LTDs have full and unlimited capacity and are not tied to an objects clause.

#### Key features

- Full and unlimited capacity.
- Limited liability of shareholders.
- One-document constitution.
- Not required to have an authorised share capital.
- May dispense with holding a physical AGM, irrespective of the number of shareholders.
- Between one and 149 shareholders.
- One or more directors.
- Name must end in “Limited” or “Ltd” (or Irish equivalent).

### 2. Designated Activity Company (DAC)

The DAC is also a form of private limited company. The format of a DAC can be either a private company limited by shares (which is similar in many respects to the LTD) or a private company limited by guarantee and having a share capital.

Private limited companies that are trading as credit institutions or insurance undertakings are required to be DACs.

#### Key features

- Capacity technically limited to objects clause in memorandum of association; however, the Companies Act 2014 specifies that the “*validity of an act done*

*by a DAC shall not be called into question on the ground of lack of capacity by reason of anything contained in the DAC’s objects”.*

- Limited liability of shareholders.
- Two-document constitution, comprising memorandum and articles of association.
- Required to have an authorised share capital.
- May not dispense with holding a physical AGM if more than one shareholder.
- Between one and 149 shareholders.
- Two or more directors.
- Name must end in “designated activity company” or “DAC” (or Irish equivalent).
- Can list any debt securities for offer to the public.

### 3. Public Limited Company (PLC)

The PLC is also a form of limited company and its key distinguishing feature is that there is no statutory limit to the number of shareholders it may have. Accordingly, PLCs are the chosen form of corporate structure where companies wish to list their shares on a stock exchange and offer them to the public.

A Societas Europea (SE) is the European equivalent of a PLC. The Companies Act 2014 specifies that a Societas Europea that is registered with the CRO “*shall be regarded as a PLC*” for the purposes of the relevant legislative provisions of the Companies Act.

#### Key features

- Capacity technically limited to objects clause in memorandum of association; however, the Companies Act 2014 specifies that the “*validity of an act done by a PLC shall not be called into question on the ground of lack of capacity by*

*reason of anything contained in the PLC's objects".*

- Limited liability of shareholders.
- Two-document constitution, comprising memorandum and articles of association.
- Must have an authorised share capital and a minimum issued share capital of €25,000.
- May not dispense with holding a physical AGM if more than one shareholder.
- Must have one at least shareholder with no statutory maximum.
- Two or more directors.
- Name must end in "public limited company" or "plc" (or Irish equivalent).
- Capacity to offer, allot and issue securities to the public.
- Unless constitution provides otherwise, directors shall retire by rotation and directors' remuneration (if any) must be determined by the shareholders in general meeting.

#### **4. Unlimited Company**

There are three types of unlimited company under the Companies Act 2014: a private unlimited company (ULC); a public unlimited company (PUC); and a public unlimited company that has no share capital (PULC).

Unlimited companies are not generally used as trading companies in Ireland as the liability of the shareholders is not limited and in a winding up situation the shareholders are obliged to pay all the debts and liabilities of the company.

##### **Key features**

- Capacity technically limited to objects clause in memorandum of association; however, the Companies Act 2014 specifies that the *"validity of an act done*

*by an unlimited company shall not be called into question on the ground of lack of capacity by reason of anything contained in the company's objects".*

- Unlimited liability of shareholders.
- Two-document constitution, comprising memorandum and articles of association.
- May not dispense with holding a physical AGM if more than one shareholder.
- Two or more directors.
- Name must end in "unlimited company" or "uc" (or Irish equivalent).

#### **5. Company Limited by Guarantee (CLG)**

The CLG does not have a share capital and, instead, the shareholders' liability is limited by its constitution to such amount which the shareholders undertake to contribute to the assets of the company in the event of it being wound up.

The CLG is the legal form of choice for charities, sports and social clubs and management companies in Ireland.

##### **Key features**

- Capacity technically limited to objects clause in memorandum of association; however, the Companies Act 2014 specifies that the *"validity of an act done by a CLG shall not be called into question on the ground of lack of capacity by reason of anything contained in the CLG's objects".*
- Limited liability of shareholders.
- Two-document constitution, comprising memorandum and articles of association.
- Cannot, and does not, have a share capital.
- May not dispense with holding a physical AGM if more than one shareholder.

- Must have at least one shareholder with no statutory maximum.
- Two or more directors.
- Name must end in "company limited by guarantee" or "clg" (or Irish equivalent).

### 6. External Companies

An external company means a company that is registered outside of Ireland, either within or outside the EEA. An external company that has limited liability and establishes a branch in Ireland must register with the CRO. External companies that do not have limited liability or do not have a branch in Ireland are not required to register in Ireland.

A "branch" is generally understood to mean a place of business which has the appearance of permanency and is equipped to negotiate business with third parties.

## III. Steps and Timing to Establish

### Incorporation Process

The process of incorporation and registration of a company commences with the delivery of a constitution together with the relevant application form to the CRO. On the registration of the constitution, the CRO will certify in writing that the company is incorporated and issue a certificate of incorporation. The certificate of incorporation is conclusive evidence that the Company is registered pursuant to the Companies Act 2014.

The CRO will not register a constitution unless satisfied that all the requirements in relation to the form of the constitution under the Companies Act 2014 have been complied with. The constitution of each company will vary depending on the type of company, but generally each must state:

- the name of the company;
- the type of company to be registered (i.e. LTD, DAC, PLC, etc);

- the objects of the company (if required, depending on company type);
- the limit on liability of the shareholders of the company (if relevant); and
- the share capital of the company divided into classes and nominal value of each share.

The application to incorporate a company must also include:

- the company name;
- details of where the company proposes to conduct its business
- the address of the registered office of the company;
- details of the proposed directors and company secretary (including name, date of birth and address);
- the consent of the proposed directors and company secretary to act;
- the initial shareholders and details of their shareholdings; and
- a description of the activity which the company proposes to engage in.

The application also incorporates a declaration by the proposed directors that the requirements of the Companies Act 2014 have been complied with in respect of the company.

The incorporation of a standard LTD can take approximately five days from the lodgement of the relevant application documentation with the CRO.

### Companies Registration Office (CRO)

The Companies Registration Office (CRO) is the public registry in Ireland for companies. The CRO is a statutory authority and has several core functions, as follows:

- the incorporation of companies;
- the receipt and registration of companies' post-incorporation documents;
- the enforcement of the Companies Act 2014 in relation to the filing obligations of companies; and



- making information available to the public.

### **Office of the Director of Corporate Enforcement (ODCE)**

The ODCE is an official office and is, together with the CRO, the principal authority for the enforcement of the Companies Act 2014. The primary mandate of the office is to improve the compliance environment for corporate activity in the Irish economy by encouraging adherence to the requirements of the Companies Act 2014 and bringing to account those who disregard the law.

## **IV. Governance, Reputation, and Ongoing Maintenance**

### **Company Officers**

#### **1. Directors**

Directors are elected personnel responsible for managing and running a company. As described above, except for the LTD, companies must have a minimum of two directors.

The Companies Act 2014 codifies the duties and responsibilities of directors, as follows:

- To act in good faith in what the director considers to be the interests of the company;
- To act honestly and responsibly in relation to the conduct of the affairs of the company;
- To act in accordance with the company's constitution and exercise his or her powers only for the purposes allowed by law;
- To not use the company's property, information, or opportunities for his or her own or anyone else's benefit (unless otherwise permitted or approved);
- To not agree to restrict his/her power to exercise an independent judgment (unless otherwise permitted or approved);
- To avoid any conflict between the director's duties to the company and the director's other interests (including personal interests) (unless otherwise permitted or approved);
- To exercise the care, skill and diligence which would be exercised in the same circumstances

by a reasonable person having both the knowledge and experience that may reasonably be expected of a person in the same position as the director and the knowledge and experience which the director has; and

- To have regard to the interests of its shareholders in addition to a general duty to employees.

Directors must be natural persons (i.e. another company cannot act as a director) and each director must be 18 years of age or older.

Undischarged bankrupts may not act as directors. Directors are also subject to rules regarding restriction and disqualification, with disqualification orders of other jurisdictions being recognised in Ireland.

There are some additional formalities for directors, including that directors are not permitted to hold more than 25 directorships in Ireland (with group companies treated as a single directorship).

In addition, while there are no nationality requirements for the directors or company secretary of an Irish company, all Irish incorporated companies must have at least one director that is resident in the EEA. If the company does not have a director that is resident in the EEA, the company must take out a bond to the value of €25,000. The annual cost of such a bond is approximately €1,000 and the purpose of the bond is to provide for certain fines or penalties that might be imposed as a result of the company's non-compliance with company and/or tax law.

#### **2. Company Secretary**

Each company must have a company secretary. A director of a company can generally also hold office as the company secretary, unless it is an LTD with a single director in which case the director and company secretary must be different.

The functions of a company secretary are a mix of legislative provisions and those duties delegated to the company secretary by the directors. The functions are primarily administrative, such as ensuring that the company's filing obligations under the Companies Act 2014 are complied with and the statutory registers of the company are maintained.

It is the responsibility of the directors to ensure that the person appointed as secretary has the skills necessary to carry out the relevant duties and functions.

If an individual, a company secretary must be 18 years of age or older. However, it is also possible for another company to act as company secretary.

### **Statutory Registers**

Companies in Ireland are required to keep and maintain certain registers. It is generally expected that the company secretary would be responsible for updating and maintaining these registers, which are usually kept at the company's registered office address.

Pursuant to the Companies Act 2014, the following registers are generally required to be kept:

- Register of members (with "members" being an equivalent term for "shareholders");
- Register of the names and details of directors and secretaries;
- Register of any shares or interests in shares held by directors and secretaries;
- Register of any instrument creating a charge; and
- Register of minutes of meetings.

### **Registered Office**

Every company incorporated in Ireland must have a registered office in the state. This is an address in Ireland to which all official communications and notices may be addressed.

## **Shareholders**

### **1. General Meetings**

Irish companies are generally required to hold an annual general meeting of its shareholders (AGM) every calendar year. As described above, certain companies may dispense with the holding of an AGM and may instead sign a written resolution to the effect of the meeting.

The directors of a company may convene an extraordinary general meeting of the shareholders of a company (EGM) whenever they consider it appropriate. A shareholder or shareholders holding 50% or more of the paid-up share capital of the company may also convene an EGM (although this percentage may be varied in the company's constitution). Shareholders holding 10% or more of the paid-up share capital of the company may request the directors to convene an EGM. EGM's are usually convened to deal with special business of the company.

General meetings will normally be held in Ireland, unless all shareholders entitled to attend and vote consent in writing to its being held outside Ireland. At least 21 days' notice is generally required for the calling of an AGM with at least seven days' notice required for the calling of an EGM.

### **2. Rights and Powers of Shareholders**

The Companies Act 2014 and the constitution of a company normally set out the powers of shareholders, by reference to their position as shareholders and the rights attaching to shares. Companies may, and often do, have more than one type of share (known as "share classes"). In such circumstances, each share class can have different rights attached to it, meaning that holders of different shares can have different rights in respect of matters

such as attending meetings, voting power and entitlements to dividends or participation in profit.

The power to manage the business of the company is generally delegated to the directors of the company, who may exercise all such powers of the company that are not required (by the Companies Act 2014 or by the company's constitution) to be exercised by the shareholders.

### **3. Shareholders' Powers where the Company is in Default**

Where a company or any of its officers is in default in complying with any provision of the Companies Act 2014, it is technically possible for a shareholder to serve a notice on the company or officers requiring the company or officers to remedy the default within 14 days. If the default is not remedied, an application can be made to the High Court for an order directing the company or officer to remedy the default.

### **4. Shareholders' Right to Seek an Investigation of a Company**

On the application of certain persons, the High Court may appoint one or more competent inspectors to investigate the affairs of a company to enquire into the matters specified. The application to the court can be by any of: the company itself; not less than 10 shareholders of the company; a shareholder or shareholders holding one-tenth or more of the paid-up share capital of the company; a director of the company; or a creditor of the company. Inspectors appointed pursuant to this procedure take their directions from, and report to, the High Court.

### **5. Shareholders' Right to Petition for Relief in Cases of Oppression**

An application can be made to the High Court by any shareholder who considers the affairs of the company are being conducted or the powers of the directors are being exercised in a manner that is "oppressive" or in disregard of his or her or their interests as shareholders. As for what constitutes "oppressive conduct", this is understood to mean the exercise of the company's authority in a manner which is burdensome, harsh, and wrong. Examples of conduct which could potentially lead to such oppressive conduct would include fraudulent and unlawful transactions, oppressive management, and exclusion of the shareholder from the management of the company.

On such an application, the High Court can make an order: directing or prohibiting any act; cancelling or varying any transaction; regulating the conduct of the company's affairs in future; for the purchase of the shares of any shareholders of the company by other shareholders or by the company itself; and for the payment of compensation.

### **V. Advantages of Establishing in Ireland**

A key feature of incorporation is that the company becomes a separate legal entity, distinct from its shareholders, recognised in law as having a separate identity and enjoying certain rights that flow from that distinction. Registered companies may also benefit from limited liability such that the assets, debts, and obligations belong to the company and not to its shareholders. The following are the consequences of incorporation and could be described as the main advantages of Irish registered companies as business organisations:

- Separate legal personality;
- Limited liability of shareholders;

- Transferability of interests;
- Perpetual succession;
- Ability to give security for borrowings;
- Formation of group structures; and
- Taxation.

There are many advantages to locating a business in Ireland, not least the evolving tax system which is a key aspect of the Irish Government's support for industry. Ireland has a corporation tax rate of 12.5% on profits earned during an active business and the top rate of personal income tax is 40%. This, together with its capital gains participation exemption, generous foreign tax credit system, membership of the EU, ever expanding double tax treaty network, the R&D tax credits system & thin capitalisation rules makes Ireland an attractive

destination for the registration of a Company and the establishment of a business.

Ireland has long been recognised as an ideal European country to establish a business. We have a well-educated, English-speaking workforce, an attractive tax regime and are closely situated to London and mainland Europe. Ireland has established itself as an easy location to start a business, a preferred jurisdiction for taxation and a front-runner for establishing European headquarters. Ireland has for years had a consistent policy of welcoming foreign-owned business and is well-positioned to continue to do so.



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# INTERNATIONAL LAWYERS NETWORK



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**ESTABLISHING A BUSINESS ENTITY IN ISRAEL**





## ESTABLISHING A BUSINESS ENTITY IN ISRAEL

### **Introduction**

The influence of British rule immediately prior to the establishment of the State of Israel has left a lasting mark on Israeli corporate law. Even though Israel is commercially much closer to the U.S., the links to the English legal system remain strong. Therefore, Israel has companies rather than corporations. The letters “Ltd.” follow the name of companies with limited liability rather than the U.S. versions of “Inc.” or “Corp.” Israeli companies have shares rather than stock, they have articles of association (but no memorandum of association) rather than certificates of incorporation and bylaws. Israel has a Registrar of Companies keeping records of companies very similar in nature to England’s Companies House. Likewise, many of the characteristics of Israel’s partnerships remain like their English counterparts. Consequently, the considerations regarding the type of entity through which to conduct business in Israel, at least as far as whether to form a company or a partnership, will be like the considerations in England and in other jurisdictions remaining heavily influenced by English law.

While there are a few different forms of “corporate” entities in Israel, this guide will focus on companies and partnerships as these are the entities that the non-Israeli businessman is most likely to set up or invest in if they are inclined to penetrate the Israeli market directly (rather than by working through an agent, distributor, etc.). The end of the guide will take a very brief look at the other kinds of entities that exist in Israel.

The information contained in this guide is only a brief summary and may not be used as actual legal advice. Please approach us if you require legal advice on any specific matters that may arise.

### **Types of Business Entities**

#### ***Companies***

Israeli companies generally limit the liability of the shareholders for the debts and obligations of the company. The precise form of the limitation of liability is set out in the company’s articles of association. Normally, liability is limited to the subscription price of the shares held by the shareholders. It is possible for an Israeli company to decide not to limit the liability of its shareholders, but this is very rare and will not be considered further, some companies are not allowed to limit its shareholders’ liability (such as lawyers’ companies). There are private companies and public companies that are publicly traded companies. The organs of an Israeli company are the general meeting of its shareholders and the board of directors. The most significant document of corporate governance for Israeli companies is the articles of association. Israeli companies formed after 1999 do not have a memorandum of association.

#### ***Partnerships***

Partnerships are formed when two or more persons or legal entities decide to get together for managing an enterprise in which they will share in the costs and profits of the enterprise. There are two main kinds of partnerships in Israel, general partnerships, and limited partnerships.

General Partnerships - Apart from partnerships formed for providing legal or accounting services, partnerships are limited to a maximum of 20 partners, whereas no similar limitation applies to a company. The partners of such partnership are jointly and severally liable to third parties for the debts and obligations of the partnership. Amongst each other, the partners will be responsible to share in the



debts and liabilities and enjoy the profits equally, unless they agree to have different shares.

Limited partnerships - consist at least one general partner (and limited to a maximum of 20 general partners), who is fully liable for the rights and obligations of the partnership and at least one limited partner, whose liability to the partnership is limited to the amount of capital he paid to the partnership upon formation of the partnership. Nevertheless, Limited partner can enjoy the profits of the partnership, according to their equity in the partnership.

Limited partners may not participate in the management of the partnership and they do not have the authority to bind the partnership. Any limited partner who does take part in the management of the partnership will be liable in the same manner as general partners for the period in which he participates in the management. A limited partner is authorized to review the books of the partnership, to examine its condition and risks and to consult on those matters with the other partners.

### ***Foreign Companies and Partnerships***

Rather than forming a new company or partnership or investing into an existing entity, non-Israeli companies and partnerships may choose to register as a "Foreign Company" and simply open office branches located in Israel.

### **Matters to be considered when choosing a particular business entity type**

#### ***Exposure to Liability:***

The fact that companies provide the owners with the protection of the "corporate veil", limiting their personal exposure and protecting them against the full consequences of potential failure of the business is a major selling point for companies. The very first shareholders of a company normally must pay a non-significant amount of money for their shares, meaning

that their total exposure can be very limited. On the other hand, general partnerships provide no protection for the partners against the debts and liabilities of the partnership. Limited partnerships must still have at least one owner who is at full risk over the partnership's debts and obligations; limited partners will normally have to pay to the partnership's capital considerably more at the outset of the partnership, rather than their counterparts setting up a new company.

Once a shareholder has sold his shares and is no longer a shareholder in the company, he no longer has any exposure for debts and obligations of the company. However, a partner leaving a partnership will continue to be jointly and severally liable for the debts and obligations of the partnership that arose during the time that he was a partner, unless the remaining partners and creditors agree otherwise.

It should be noted that the Israeli courts are empowered to pierce the corporate veil and hold shareholders personally liable for actions and debts of the company. Such occasion occurs when the court determines that the corporate veil was exploited to unjustly deprive or defraud a creditor or other third party, or for the purpose of taking unreasonable risks. While courts were once hesitant to use this sanction, in recent years the trend has changed, nowadays courts are trying to find reasons that justify piercing of corporate veil. However, generally, an element of wrong doing is still required to justify the court decision, rather than simple bad business choices. **Taxation**

The company is an entirely separate legal entity from its shareholders for tax purposes and its income is considered to be separate from the income of its shareholders. The Israeli Income Tax Ordinance imposes a two-level taxation system for companies. The first level is at the corporate level and involves the payment of



corporate tax by the company itself on the profits of the company. During the year, companies must make monthly advance payments of the income tax, based on their current revenues, which will be finally calculated at the end of the year. The percentage is set on an ad hoc basis by the Israeli Tax Authority and is based on past performance of the company. Once the company's bookkeeping is completed at the end of the year, the company will be required to make up any shortfall or will receive back any excess taxes paid. The current tax rate for Israeli companies in 2016 is 25%. However, due to tax benefits provided by number of laws, in many cases the company's tax rate serves as a starting point, which is reduced by using such laws.

The second corporate taxation level is at the shareholder level, which occurs when the company distributes dividends to its shareholders. This tax is paid by the company as a withholding tax and deducted from the dividend amount actually paid to the shareholders. The tax rate for dividend payments is set according to the shareholder's holding in the company, for shareholders holding up to 10% in the company's share capital the tax rate is 25% of their dividends; and for shareholders holding over 10% of the company's share capital the tax rate is 30% of their dividends. Dividend distributions paid to a shareholder that is an Israeli company is not taxed. However, in cases which the shareholder is a foreign company, the dividend distribution will be taxed.

Shareholders also have to pay tax on capital profits made on the sale of shares. The tax rate is as per the rates applied to dividend payments.

**Partnership** - Partners are taxed on an individual basis in accordance with Israel's income tax rates for individuals, the tax rates for individuals are currently a progressive tax

rate varying from 10% to a maximum rate of 48%. The partner is taxed based on the income earned both within and outside the partnership. For a partner that is an Israeli company, the income derived from the partnership will be included in the calculation of the company's profits, and will be taxed in accordance with the abovementioned provisions relating corporate tax.

The partnership must elect a "Head Partner" who will be responsible for preparing and delivering to the Tax Authorities a report of the partnership activity, its partners and the portion of the partnership's profits and losses that each partner is entitled to. The Head Partner must be an Israeli resident. Once a year, after a partner has received his part of the partnership income, he will report his income to the Tax Authority.

### ***Raising Finance***

The company format is more convenient for the purposes of raising finance than that of partnerships. Both companies and partnerships may borrow loans and lines of credit from banks, other lenders and suppliers, but the corporate veil of the company described above provides more protection to the company shareholder than the partner in the event of default.

When looking to increase capital equity, adding new investors to a business as shareholders is an easier process than adding new partners. Persons that do not have a particularly close relationship with the owners of a business, but who are nonetheless interested in investing in the business for its potential, are likely to find the safety of the corporate veil more appealing than the risks involved in buying into a partnership.

For the types of business that have the potential for a valuable "exit" for the founders, the company format is much more suitable



than the partnership for achieving mergers, acquisitions and going public.

Adding new partners to a partnership is considered as a tax event and might affect a tax payment by the existing partners.

### **Liquidation**

As will be discussed in more detail below, the steps required for forming and registering a company, partnership or a branch of foreign company or foreign partnership all have relatively similar steps and costs involved. However, liquidation and dissolution of an Israeli company is much more complex than liquidation of a partnership.

Unless a partnership agreement provides otherwise, a partnership will dissolve upon a partner notifying the rest of the partners that he wishes to leave the partnership. Generally, partnership agreements will provide for a certain percentage majority vote of the partners for liquidation of the partnership and this may be by regular majority. Upon liquidation of a partnership, the debts and obligations of the partnership vis-à-vis third persons remain the debts of the partners, meaning that creditors still have a target for claims. Therefore, less regulation is involved in liquidation of partnerships. Upon liquidation of a partnership, the assets and profits of the partnership are first used to pay off creditors. If there are not enough assets and profits for these purposes, then the partners must dig into their own pockets. Once all debts have been paid off, any remaining amounts are used to refund partners for their contributions to the capital of the partnership and any remaining surplus distributed to the partners according to pro rata rights.

Liquidation of a company, even voluntary liquidation, is a more complex process. Liquidation of a company is generally divided into two different procedures: liquidation by

court, also known as forced liquidation, and a voluntary liquidation. In such case, the company adopts a resolution for its own liquidation. A forced liquidation involves strict supervision of the Court and so it is a lengthy process and expensive one. The process usually commences with a motion filed by a creditor of the company, and is followed by appointment of a liquidator by the court and the involvement in the process of the official receiver. Voluntary liquidation is suitable to a solvent company and normally does not involve the court in the process (unless there is a reason for the court to take over and supervise the process). It is a process that is initiated by the company itself and supervised by the Registrar of Companies. Although it is much simpler and less expensive than a forced liquidation, the entire process usually lasts approximately a year until the company is declared dissolved by the registrar. The process involves convening of two general meetings, the filing of several notices and reports with the Companies registrar, in different stages of the process, as well as two publications in the official gazette (in Hebrew "Reshumot"). The liquidation of a company as opposed to the liquidation of a partnership, even a voluntary liquidation, is therefore more expensive, complicated and time consuming.

Closing an Israeli branch of a foreign company or partnership is a simpler process as the company or partnership remains in existence and creditors continue to have a legal entity against which they can make claims. Of course, there may be costs involved in the event of early termination of existing contracts such as leases and non-compliance with existing contractual obligations.

### **Shareholders and directors**

Israeli law provides for various standards, requirements and duties that shareholders, officers, directors, and partners must comply



with. In certain cases, directors and officers can be held personally liable to their companies' shareholders, creditors, and employees for failing to meet those duties and standards. In a private company (which did not issue bonds to the public), the qualifications required of a director are very minimal, the law provides that a person to be appointed as a director may not be a minor, incompetent or have declared bankruptcy.

#### ***Companies - Rights of Shareholders:***

- **Votes.** Shareholders voting rights are attached to their shares. Normally, the shareholders have the right to one vote per share, though the articles of association may provide for shares that have no votes attached, shares with more than one vote attached and shares that have veto rights in connection with certain decisions. Most shareholder decisions are made on a simple majority (51%) basis, although the company's articles may provide that certain decisions require a special resolution with a bigger majority vote. The Companies Law also requires that certain decisions require different voting majorities, for instance in the case of voting in favor of mergers. Moreover, some resolutions require the majority of the minority interests among the shareholders. As discussed above, the Companies Law also enables the court to overturn decisions of majority shareholders where the purpose of the resolutions was to unfairly deprive or exploit the rights of the minority.
- **Dividends.** Dividends are payments to the shareholders arising because of their shareholding. Dividends may be paid in cash or in kind. All shareholders are entitled to a share of the dividend distribution calculated in accordance with

their pro rata shareholding in the company. However, where the company has different classes of shares, the company's articles of association can provide that certain classes of shares have preferences to receive dividend distributions prior to other classes. Dividends may only be paid out of the company's profits as defined in the Companies Law and set out in the company's audited financial reports; moreover, the dividend distribution is subjected to the solvency of the company. The company's board of directors have the power to declare dividend distributions, unless the articles provide otherwise. Under the Companies Law, the company's articles may prescribe that (i) dividends will be recommended to the shareholders by the directors and the shareholders may then approve, reject or decrease the dividend distribution; or (ii) the shareholders in general meeting may prescribe a maximum amount for the dividend and the directors will then decide on the amount of the distribution.

- **Rights to Share in Assets Remaining on Liquidation of the Company.** Upon liquidation of a company, the company's affairs and assets are to be managed by a receiver whose task is to liquidate the assets and pay off all the company's creditors. Should there be any amounts left following payment of all a company's debts, those amounts are to be distributed to the shareholders in the same manner as division of dividend distributions described above.





## Steps and Timing to Establish

### **Companies**

Companies are principally governed by the Companies Law 1999 (the "**Companies Law**") and regulations promulgated thereunder.

Israel has a Registrar of Companies, which is run by the Ministry of Justice. All Israeli companies must be registered with the Registrar of Companies. Therefore, a person wishing to form a company must file an application to establish the company with the Registrar of Companies. The application form is prescribed by regulations and may be downloaded from the Registrar's website (<http://www.justice.gov.il/MOJHeb/RasutHataa gidim/RashamHachvarot/>).

Non-Israeli persons may establish companies in Israel. Where the application form requires an Israeli to enter their Israeli ID number, non-Israelis are required to provide their passport number, details of the country that issued the passport and a certified copy of the passport. Non-Israeli corporate entities may also file applications with the Registrar to establish Israeli companies. This will require the foreign entity to provide a certified copy of its certificate of incorporation or other formal proof of incorporation from the country of its incorporation, together with a notarized Hebrew or English translation thereof.

Formation of a company also requires:

- **Filing of the company's articles of association**, which set out the rights and obligations of the shareholders, directors and officers and the rules of corporate governance of the company. Articles may be a simple one-page document or extremely detailed running into tens of pages. Any item of corporate governance that is not expressly prescribed within the articles will be determined by the

Companies Law. The articles must contain at the least, the company's name, the purposes of the company (which is usually drafted very widely to cover any legal activity), the authorized share capital of the company, detailing the number, classes, and nominal value of shares, whether or not the liability of the shareholders is limited and how it is limited, and the registered office address. A company's shares can be divided into different classes of shares, with the company's articles describing the rights attached to each class. The articles of association must be filed with the Registrar in Hebrew.

- **Filing of the Declaration of the First Directors of the Company**, in which they declare their competence to serve as directors.
- **Payment of the registration fee**, which is currently NIS 2,640 (app. US\$ 680).

It normally does not take long to establish a new company, with times from filing the documents with the Registrar of Companies being normally 4 business days.

### **Partnerships**

Partnerships are principally governed by the Partnership Ordinance 1975. The Ministry of Justice also runs a Registrar of Partnerships.

#### **1. General Partnership**

A general partnership comes into existence automatically when at least two persons commence a relationship that they intend to be in the form of a partnership. A partnership that is formed to conduct business must provide notice of its establishment to the Registrar of Partnerships within one month from the date of establishment. The notice must contain the following details: (a) Name of



the partnership; (b) the business to be ordinarily conducted by the partnership; (c) full name, address, and definition of each partner; (d) names of the partners who are authorized to manage the interests of the partnership and to sign on-behalf of the partnership, unless all partners are so authorized; (e) term of the partnership, if it is to last for a defined period of time from its formation. A general partnership does not require a written partnership agreement for its establishment, though it is normally recommended. For instance, without a partnership agreement stating otherwise, partners cannot join or leave a partnership without dissolving the existing partnership and forming a new partnership with the new constitution of partners. Partnership agreements, for both general and limited partnerships must be filed with the Registrar of Partners in Hebrew.

Registration of a general partnership in 2016 costs a fee to the registrar of NIS 967 (app. US\$ 250) and payment of an annual fee of NIS 1,131 (app. US\$ 290) if paid until 28.2.16 or NIS 1,503 (app. US\$ 390) if paid thereafter.

## **2. Limited Partnership**

Establishment of a limited partnership requires a written partnership agreement. The Registrar of Partnerships must be sent a notice of the establishment of the limited partnership. In addition to those details that must be contained in the notice concerning establishment of a general partnership, the notice must also state that the partnership will be limited, details of each limited partner and the amounts which each limited partner paid in to the capital of the partnership and

whether the amount was paid in cash or details of the method of payment.

Registration of a limited partnership currently costs a fee to the registrar of NIS 2,615 (app. US\$ 680) and payment of an annual fee of NIS 1,110 (app. US\$ 290).

It normally does not take long to establish a new partnership, with times from filing the documents to the Registrar of Companies being up to 7 business days.

### ***Non-Israeli Company Branch***

A non-Israeli company may simply open a branch in Israel rather than establishing a subsidiary. This requires the foreign company to file an application with the Registrar of Companies to register as a foreign company within a month after the company established business in Israel. Certified copies of the company's relevant documents of incorporation from its home country and its documents of corporate governance such as articles, memorandum, etc. will need to be attached to the application together with a notarized translation. The foreign company would also need to provide a list of its directors and the name and address of an Israeli based person who is authorized to receive formal notices and service of court pleadings on-behalf of the company and a certified copy of a formal power of attorney authorizing a person normally residing in Israel to conduct business on-behalf of the company in Israel.

The fees payable to the registrar to establish an Israeli branch of a foreign company are the same as the fees payable to establish an Israeli company as described above.

### ***Non-Israeli Partnership Branch***

Partnerships formed and existing abroad may open a branch in Israel. To conduct business in Israel through a branch, the foreign partnership must register with the Registrar of Partnerships,



providing the same details to the Registrar as are required for registration of Israeli partnerships and the same fees must also be paid. Foreign limited liability partnerships must also include in addition to the above a notification that the partnership is limited with the details of the limitation as well as attach the partnership formation agreement, submitted with a notarized translation to Hebrew. The registrar will then apply to the Minister of Justice for approval to be registered in Israel, and the Minister of Justice has sole and absolute discretion to determine whether to approve such requests.

The fees payable to the registrar to establish a foreign partnership are the same as the fees payable to establish an Israeli partnership and described above in this section under "Partnerships".

### **Governance, Regulation, and Ongoing Maintenance**

#### ***Brief summary of regulation of each type and ongoing maintenance, reporting requirements***

##### *Companies*

Both private and public Israeli Companies are principally governed by the Companies Law and regulations promulgated thereunder. There are also various requirements of public companies contained in the Securities Law of 1968 and regulations promulgated thereunder. As Israel is a common law jurisdiction, there is also a great body of case law interpreting and applying the requirements of the statutes.

Israeli companies must comply with the following requirements on an on-going basis:

- Appoint an outside accountant as its auditor. However, private companies with annual revenue of less than NIS 610,509.92 (app. US\$ 158,570) NIS 610,509.92 may vote in a general meeting of shareholders to waive the requirement

to appoint an auditor, provided that not more than 10% of the shareholders votes of the company opposing to that particular manner.

- Pay an annual fee of NIS 1,503 (app. US\$ 390) (in 2016). Public companies must pay an additional fee each year on August 1, the amount being determined by a proportion of its capital equity.
- Hold an annual general meeting ("AGM") of shareholders at least once a year with no two AGMs being held more than 15 months apart. A private company may prescribe in its articles of association that it is not required to hold AGMs, but it must then convene a general meeting of shareholders anytime it is requested to do so by any director or shareholder.
- File an Annual Report to the Registrar of companies once a year within 14 days of the AGM unless the company is exempted from holding an AGM, as described above. This is not a financial report, but rather a report in a form prescribed by regulations and downloadable from the Registrar's website. It is intended to provide the Registrar with up-to-date details of the Company's directors, shareholders, share capital, registered office and other such details. Israeli Public companies have also obligations to publish financial reports in the manner set out in the Securities Law 1968.
- Other reporting obligations to the registrar of companies such as: change of the company's name, purposes, and Article of Association, share issuance or transfer, capital increase, liens, changes in the board etc.



### *Partnerships*

Israeli partnership law requires little ongoing maintenance and reporting.

Israeli and foreign partnerships have to comply with the following requirements on an on-going basis:

- Similar to a company, pay an annual fee of NIS 1,503 (app. US\$ 390) (in 2016).
- Notify the Registrar within 14 days of any changes to the information contained in the documents delivered to the Registrar.

### Requirements for local shareholding/directors.

The law does not provide any requirement for a minimum number of local shareholders, directors, or partners for either companies or partnerships.

### Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions

There are no significant barriers.

#### ***Any capitalisation obligations***

There are no specific capitalisation obligations in terms of minimum capitalisation ratios for either companies or partnerships.

#### ***Any special business or investment visa issues***

There are no special business or investment visa issues in terms of specific requirements for entities to conduct business or invest in businesses in Israel. There are work visas requirements for non-Israeli citizens that intent to work in Israel.

#### ***Any restrictions on remitting funds out of the jurisdictions (withholdings, etc.).***

Dividend distributions paid by Israeli companies to their shareholders (see above for more details) are deducted by the company at source before payment of the dividend.

### ***Other forms of Israeli Entities***

#### *Cooperative Society (in Hebrew "Agudah Shitufit")*

This is a form of entity that has many similar characteristics with a company, while having seen through tax rules that are more closely related to partnerships. Cooperative society is a form of entity that was designed with certain types of Israeli societies in mind such as kibbutzim and in fact, many Israeli kibbutzim are incorporated in the form of cooperative societies. Businesses set up by kibbutzim are often also set up as cooperative societies. In most cases those cooperative societies are wholly owned or almost completely owned by the kibbutzim. When outside investment is sought, they often first convert into regular companies.

#### *Voluntary Association (in Hebrew: "Amuta")*

This form of corporate entity is usually established for non-profit purposes. Such associations are normally established to run charities and other non-profit initiatives and enterprises, such as the operation of schools and colleges. As this type of corporate entity is not used for profit making enterprises, it will not be covered further in this work.

#### ***Public Benefit Company***

This form of corporate entity (hereunder: "PBC") is as its name implies, a company formed under a definitive set of purposes, for the benefit of the public. It is formed with an application filed with the Registrar of Companies, and its method of formation is similar to that of the company described above. As a company, it has a definitive share capital, shareholders, and rights of ownership. However, a PBC, by its nature, must strictly adhere to the specific standards and purposes for which and under which it was formed. For example, the Company Law prohibits any



distribution of dividends to the shareholders of a PBC, as this would mean a personal gain to its shareholders. For non-profit organizations wishing to employ the legal and organizational

advantages of a company, this type of corporate entity is thus a popular alternative to a Voluntary Association as described above.





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# INTERNATIONAL LAWYERS NETWORK



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ESTABLISHING A BUSINESS ENTITY IN ITALY

ILN CORPORATE GROUP

## ESTABLISHING A BUSINESS ENTITY IN ITALY

### 1. Types of Business Entities

#### 1.1 Premises

The Italian law provides multiple forms of organizational structures in order to do business in Italy, which differ from one another due to the extent of the liability undertaken by their participants. In particular, certain business organizational forms allow the participants to limit their personal liability (such as the “società per azioni” - a type of company similar to the Joint Stock Company - or the “società a responsabilità limitata” – similar to the Limited Liability Company -), as opposed to others which do not limit the liability of the participants (among which the “società semplice” and the “società in nome collettivo,” operating similarly to a partnership) or which provide for limitations to the personal liability only for certain classes of stakeholders (i.e. the “società in accomandita semplice” and “società in accomandita per azioni”).

Most foreign investors generally enter the Italian market through the organizational structures that provide a limited liability for the participants. Discussed below are the two most common types of corporate entities that provides such limited liability, i.e. the “Società per Azioni” (“S.p.A.”) and the “Società a responsabilità limitata” (“S.r.l.”), including a simplified type of the S.r.l., the “Società a responsabilità limitata semplificata” (“S.r.l.s.”). In each of these types of corporations, in fact, the maximum extension of the shareholders’ personal liability is limited to the amount of their equity interest.

#### 1.2 Description of the types of entities available in Italy, through which to conduct business.

##### 1.2.1 “Società per Azioni” (S.p.A.)

The *Società per Azioni* represents the main

corporate vehicle generally utilized for investments of higher significance and value, either by foreign and domestic investors.

A minimum capitalization of Euro 50.000 (fifty thousand) is in fact required to set up an S.p.A. The capital of the S.p.A. is subdivided into shares and is required to be fully subscribed, although only 25% of its value may be paid in at the time of incorporation. The remaining subscription price will have to be paid up upon request of the administrative body of the company, in one or more installments.

As mentioned above, the S.p.A. confirms the general principle of the limited liability of its shareholders in case of insolvency of the company, which will be limited to the maximum amount of the share capital actually subscribed by each shareholder. This principle finds an exception in the event that the S.p.A. is set up, or is subsequently owned, by a sole shareholder. In such cases, in fact, the sole shareholder may be held personally and unlimitedly liable, unless such sole shareholder does pay up in whole the entire share capital and fulfils certain publicity requirements disclosing to the public the sole ownership in the company.

The main provisions regarding the governance and the capital of an S.p.A. are regulated by the articles of association, which are approved by the shareholders at the time of incorporation and may be amended only by a resolution of the extraordinary meeting of the shareholders, requiring enhanced voting majorities.

In addition to the above, it should be remarked that stricter legal provisions have been established by the Italian Civil Code with respect to those particular S.p.A.’s whose stock is traded on one of the official regulated markets or is highly capitalized and diffused

on the market.

### 1.2.2 “Società a Responsabilità Limitata” (S.r.l.)

The *Società a responsabilità limitata* is the most commonly used form of limited liability company in Italy, with a minimum capitalization requirement of Euro 10.000 (ten thousand).

On the other hand, the equity participation in the S.r.l.’s capital is not represented by shares, but by quotas. Such quotas are “immaterial”, i.e. they cannot be incorporated into certificates, with the result that the circulation and the transfer of the same are subject to more strictly formal requirements.

In general terms, the S.r.l. is characterized by a greater freedom granted in favor of the quotaholders to set forth the internal organizational rules of the company, and to create a very flexible structure adaptable to their peculiar needs.

The flexibility of its structure, along with the sensibly lower costs required for the incorporation and management of the S.r.l., as opposed to the S.p.A., makes the former the most suitable and commonly utilized corporate form to start and run small/medium size businesses.

Pursuant to a recent modification to the Italian Civil Code it is now allowed to constitute the S.r.l. with a corporate capital lower than 10.000,00 Euro, save that the following limitations will apply: 1) the equity contributions must be paid only in cash and fully paid to the persons that are entrusted with the administration of the company; 2) an amount correspondent to one fifth of the net profits must be set aside as legal provision until the S.r.l.’s net assets will approach 10.000,00 Euro; 3) the legal provision can be only used for ascribing it to the corporate

capital, or to cover possible losses, and must be always replenished if reduced.

### 1.2.3 “Società a Responsabilità Limitata Semplificata” (S.r.l.s.)

The *Società a responsabilità limitata semplificata* is a particular kind of S.r.l. that has been introduced by the Legislative Decree n. 1/2012, under article 2463 bis of the Italian Civil Code.

The purpose of the introduction of such company is to foster new enterprises and small business, by simplifying the incorporation proceedings and by reducing the capitalization requirement.

The act of incorporation must be drafted in compliance with the standard model approved by Decree of Justice and the equity contribution can be limited to the minimum amount of Euro 1,00, that must be completely subscribed and directly paid-in, in cash, to the administrative body at the time of incorporation.

Further limitations in respect to the ordinary S.r.l. structure are: (a) the founder quotaholder(s) must be individual(s), (b) the inter vivos transfer of quotas can only be executed with other individuals, and (c) the capital can only be raised up to the maximum limit of Euro 9.999,00.

## 1.3 Groups of Companies

As one of the results of the reform of the Company law approved with Legislative Decree January 17, 2003, n.6, (“Reform”), the Italian legal system now regulates certain aspects connected to the common practice of organizing business activities through the establishment of groups of companies.

While the law does not directly define the term “group of companies”, it refers to the concepts of “activity of direction and co-ordination of companies,” of “coordinating company” (i.e. the

mother company) and of “coordinated company” (i.e. the controlled company or subsidiary). Furthermore, the law does not indicate or list the actual cases in which the activity of direction and co-ordination of companies is deemed to exist, but it sets forth only a few general rebuttable presumptions of its existence. More precisely, the activity of co-ordination and direction is presumed to be exercised towards those company’s subject to consolidation in the balance sheet of another company or subject to the control of another company pursuant to the definition of “control” indicated by the Italian Civil Code. Accordingly, a similar presumption of law applies when the actual direction and co-ordination of companies is exercised by virtue of specific contractual provisions among companies (i.e. domination contracts, shareholders agreements), as well as of clauses set forth in their respective articles of association.

The approach of the legislator has been practical. Instead of construing a fixed definition of group of companies, it has taken in consideration the most typical effects connected to the relevant phenomenon (i.e. the co-ordination and direction of one company over another) and has left to the case law and the scholars the task of interpreting and updating from time to time the actual definition of such activity. At the same time, the new provisions of law have had the merit to finally recognize the phenomenon of groups and to finally confirm that the activity of co-ordination and direction is lawful so long as it is practised properly. Prior to the Reform, in fact, the lawfulness of such practice has been highly debated amongst the Italian scholars and case law.

It should be noted that the new provisions of law have restricted and sanctioned only any possible abuse of such activity, providing a specific duty for the directors of the co-

ordinated company to supervise and control the proper conduction of such practice. More precisely, the Italian Civil Code now provides, inter alia, for: (i) a specific liability of the coordinating company; (ii) the introduction of a specific “duty of transparency” for the coordinated companies; (iii) specific cases in which the shareholders of the co-ordinated companies are entitled to withdraw from such companies; and (iv) new dispositions concerning the practice of shareholders’ financing.

### **1.3.1 Liability of the Co-Coordinating Company**

The coordinating company may be held liable vis-à-vis the (minority) shareholders or the creditors of the coordinated companies whenever: (i) the coordinating company, while exercising the activity of direction and co-ordination, acts in its own interests and in violation of any criteria of correct and proper management; and (ii) such acts cause damages to the value of the shareholding of the coordinated company or to its profitability, or otherwise cause damage to the integrity of the equity and of the overall assets of the coordinated company representing the main guarantee for such company's creditors.

The aforementioned liability is in any case excluded when: (i) said acts, and the prejudices caused to the single coordinated company, are outweighed by the overall practical advantages arising from such acts in favour of the entire group of companies; (ii) the damages to the shareholders or the creditors of the coordinated company is fully eliminated by the coordinating company, also by means of instruments or measures adopted with this specific purpose (e.g. cash injections in the coordinated company for an amount equal to the - presumed - damage only in order to exclude the

aforementioned liability).

The importance of the above provisions may be better appreciated considering that, in the event that the coordinating company is found liable according to the above, such liability shall not be limited to the value of the equity interest owned by the coordinating company in the coordinated company, but will follow the ordinary liability rules. Moreover, such liability may be extended to any person who participates in the performance of the harmful act or otherwise obtains advantages by such act (within the limit of the actual benefit obtained). This latter provision further extends the number of individuals/entities that could be found liable (e.g. coordinated company's directors, auditors, other shareholders, creditors, and the like).

### **1.3.2 Duty of Transparency**

The Reform has introduced a special legal regime of publicity in relation to the groups of companies. In particular, it is now required to fully disclose to third parties the status of coordinated company, by mentioning such status on any document and correspondence of the coordinated company. Furthermore, both the coordinating and the coordinated companies are required to be registered into a specific section of the Registrar of Companies.

Directors not complying with the aforementioned duties can be held personally liable for the damages that the lack of knowledge of the coordinated status has caused to the shareholders or to any third parties (primarily the company's creditors). Moreover, the directors of the coordinated company are further obliged to: (i) report the main financial data of the coordinating company on the balance sheet of the coordinated company; (ii) indicate in the directors' report (to be attached to the

balance sheet) all the relationships and transactions (and their relevant business and economic effects) undertaken with the coordinating company and/or any other company belonging to its group; (iii) justify the decisions taken by the managing body of the coordinated company every time the same are influenced by the coordinating company.

### **1.3.3 Rights of Withdrawal**

To protect the minority shareholders of coordinated companies from prevailing resolutions passed by the majority shareholder expressing the will of the coordinating company and which may be prejudicial for the interest of the former, the Reform has introduced specific provisions entitling such minority shareholders to withdraw from the coordinated company. Such rights may be exercised when resolutions are passed changing the corporate purpose of the coordinated company or the actual business (and consequent financial risk) connected to its activities, or when the direction and co-ordination activity starts or ceases and such circumstances determine a change of such risk.

The above-mentioned causes of withdrawal cannot be excluded by the by-laws (which in turn may provide for further causes of withdrawal). The terms and conditions of the exercise of the withdrawal are regulated by the general rules set forth for the withdrawal within the S.p.A. and the S.r.l.

### **1.3.4 Provisions Concerning the Financing from Shareholders**

One of the most sensitive aspects of groups of companies which may lead to abusive and fraudulent practices against creditors and third parties relate to the financial relationships among the companies belonging



to such groups.

The inherent risk registered in this case is the attempt to abuse the corporate veil and to make recourse to financing methods instead of adequately capitalizing the coordinated company in order for the mother-company to limit its direct liability.

With the aim of limiting this practice, the Reform has introduced general provisions aimed at guaranteeing higher protection of the third parties' credit rights. The general rule introduced by the Reform in this regard states that: (i) any reimbursements of financing made available by the shareholder(s) to the participated company are subordinated to the actual payment of any other debt of the company, and that (ii) any reimbursement of such financing occurred in the year preceding the declaration of bankruptcy of the participated company shall be revoked (by the trustee of the bankruptcy proceeding). However, it should be pointed out that this general rule shall apply only for those loans and financing granted to the company at a time in which there was an excessive difference between the net equity of the company and its indebtedness (i.e. equity/debt ratio), or it would have been more reasonable to execute a direct equity contribution rather than granting loans.

#### **1.4 Branches – Stable Organization**

Foreign companies that establish one or more branch offices with permanent representation within the Italian territory are subject - for each of such branch offices - to file in the Corporate Register legalized copies, furnished with sworn translation of (i) the Foreign Company's incorporation deed and articles of association (in case of EU foreign company, the articles of association can be substituted by a certificate issued by the competent register

of companies); (ii) notarized copy of the minutes of the Foreign Company's competent body that has resolved to establish the branch office(s), filed with an Italian Public Notary; (iii) the name, place and date of birth, residence in Italy of the person(s) who permanently represent(s) the company and the power assigned to such person(s).

Until the above-mentioned formalities have been fulfilled the person(s) who act in the name and on behalf of the company are unlimitedly liable, jointly and severally with the company for its obligations, despite the limited liability of the company in the country of residence.

The ongoing activity of the branch implies the duties of filing the annual financial statements of the foreign company, and the profit and loss account of the branch. The branch must file with the Italian tax authority the tax return pertaining to the income produced in Italy.

The branch has no minimum capital requirement, rather is generally provided by the foreign company with an endowment fund.

#### **1.5 Matters to be considered when choosing a particular business entity type**

The S.p.A. equity participation represented by shares rather than quota makes this type of company preferred to the S.r.l. for confidentiality reasons, as the names of the shareholders are not registered on the Corporate Register and for the easier circulation of the ownership of the property rights.

The S.p.A. structure and functioning makes them more suitable also in case of widespread corporate participation.

On the contrary, the S.r.l. are preferred for the lower capitalization requirements, greater governance flexibility, higher possibility of participation of the business owner(s) in the management of the company and in the conduct of the business activity. Thus the S.r.l. is

the most suitable company structure for businesses when ownership and management responsibilities stay in the same persons.

Higher capitalization requirements, more sophisticated and less flexible governance provisions, need to appoint statutory auditors (regardless the size and financial dimension of the company, as described below), make S.p.A. the appropriate type of company for large size business enterprises. Furthermore, only S.p.A. qualifies for listing in the stock market.

Thanks to the special regulations governing the S.r.l.s., this type of company represents the most suitable structure for the conduct of small businesses.

Share capital represented by shares rather than percentage quota participation in the value of the capital makes the S.p.A. preferable for confidentiality reasons, circulation of property rights and in case of large shareholders' participation.

Either than for the above reasons the S.r.l. is usually considered the best company type for companies with one sole shareholder or where the shareholders are also active in the business management.

S.r.l. is the usual type of companies chosen for the incorporation of Italian subsidiaries of foreign companies.

## 2. Steps and Timing to Establish

### 2.1 Brief overview of steps to incorporate/constitute each

#### 2.1.1 S.p.A.

To incorporate an S.p.A., the shareholders - either in person or by proxy - shall appear before a Notary Public who will be required to draft the public deed of incorporation. that must contain the following main information (i) name of the founding shareholders and respective equity; (ii) name

of the company and municipality where the headquarter is located; (iii) company's object; (iv) amount of subscribed and paid capital; (v) number and type of issued shares; (vi) value of contributions in kind; (vii) criteria for distribution of profits; (viii) governance rules and administrative body composition and powers to represent the company; (ix) composition of the statutory auditor board and appointment of its members; (x) duration of the company.

The Notary Public shall verify, inter alia, that (i) the company's capital has been fully subscribed; (ii) at least 25% of the capital has been paid up (unless it has been subscribed by a sole-shareholder, in which case the capital will have to entirely be paid up); and (iii) any governmental authorization or other condition, required by any applicable law in order for the company to validly carry out its activities, have been obtained or met. The documents attesting the incorporation of the company shall then be filed with the competent Registrar of Companies within 20 days from incorporation and, once it will be filed, the company shall acquire full legal personality.

#### 2.1.2 S.r.l.

The procedure for the incorporation of an S.r.l. is very similar to the procedure described for the S.p.A. Likewise, same rules apply as regards the cases in which the company is incorporated, or is subsequently owned, by a sole quotaholder.

#### 2.1.3 S.r.l.s.

The incorporation procedure of the S.r.l.s. differs from the other companies only for the fact that the incorporation deed must meet the minimum standard content required pursuant to Chart A of the Ministry of Justice Decree no. 138/2012.

Moreover, the incorporation deed of the S.r.l.s. is free of stamp and registry duties, and also of notary fees.

### 3. Governance, Regulation, and Ongoing Maintenance

#### 3.1 Brief summary of regulation of each type and ongoing maintenance, reporting requirements

##### 3.1.1 S.p.A.

###### a) Shareholders' Meetings

The main decisions regarding the S.p.A.'s activities, structure and governance, are generally passed by resolution of the shareholders' meeting, which represent the highest corporate body of this form of company.

The shareholders' meetings are classified as (i) ordinary or (ii) extraordinary, depending on the resolution to be adopted and on the relevant matter.

With the sole exception of the companies adopting the dualistic system of governance, which will be illustrated below, the ordinary meeting shall resolve, inter alia, on the:

1. approval of the yearly financial statements and the related decision on profits/losses destination;
2. appointment and revocation of the directors and management body;
3. appointment and revocation of the auditors and of the chairman of the board of auditors and, should this be the case, the individual or the entity entitled to exercise the accounting control;
4. compensation of the directors and auditors (unless this has already been set out in the incorporation deed);
5. liability action against the directors

and against the auditors.

The ordinary shareholders meeting of an S.p.A must be held at least once a year (in order to approve the balance sheet of the company). The extraordinary meeting shall resolve on matters of higher significance and relevance for the life of the S.p.A., as the amendments to the articles of association or the appointment (and determination of powers) of the liquidators of the corporation. Extraordinary meetings shall be held before a notary public and require higher majority quorums than those required for ordinary meetings in order to validly pass the relevant resolutions.

The right to vote is regulated under Article 2351 of the Italian Civil Code, that states the general principle "one share, one vote".

However, the Bylaws may derogate to this principle and provide for the creation of non-voting shares, as well as limited voting shares according to particular topics, or subject to not merely potestative conditions. The value of these "different" shares may not exceed half of the share capital.

Following the amendments introduced by Law Decree no. 91 of June 24, 2014, the Bylaws may provide for the creation of shares with multiple voting rights also limited to particular topics or subject to not merely potestative conditions (s.c. "azioni a voto plurimo"). Each multiple voting share may entitle the holder to express up to a maximum of three votes.

The new provisions about multiple voting shares do not apply in case of special laws applicable to the Company and in any case of listed companies.

###### b) Administrative Body

The governance of an S.p.A. can be exercised through three different systems:

(i) the “traditional” system, composed of a board of directors, or a sole director, and a board of auditors; (ii) the “monistic” system, composed of a board of directors and its internal body named control committee; or (iii) the “dualistic” system, composed of an administrative board and a surveillance board.

### **b.1) The Traditional System**

The traditional system of corporate governance of an S.p.A. is based on the simultaneous presence of two separate bodies, i.e. (i) the administrative body (board of directors or a sole director), which oversees the management of the company, and (ii) the board of statutory auditors, which is mainly in charge of controlling the management of the company and the compliance of the company’s activities with the law and the by-laws.

Directors are appointed by the shareholders’ meeting for a term not exceeding three years. The appointment can be renewed. The directors are not required to be Italian citizens or permanent resident in Italy. Furthermore, individuals who have been declared legally incapable or bankrupt, as well as those who have been sentenced to a penalty entailing interdiction from public offices, even if temporary, or inability to exercise managerial functions, may not be appointed as directors.

The board of directors may delegate part of its own powers either to an executive committee, composed of some of its members, or to one or more of its members (managing directors), or both. The directors so delegated are held to a periodical and broad duty of information towards the board of directors and the

board of statutory auditors, with respect to the general performance and prospects of the company as well as to the most relevant transactions entered into on behalf of the company and of any subsidiary controlled by the latter. Finally, it should be specified that the delegation of powers to the managing director/s or to the executive committee does not imply that the board of directors renounces to such delegated powers, but only that the principle of the collegial exercise of said powers is waived. Thus, the board of directors will always retain a parallel competence and power in addition to those granted to the managing director/executive committee.

As regards the board of statutory auditors, it is composed of three or five statutory auditors, plus two alternate auditors. The statutory auditors are appointed by the shareholders’ meeting and stay in office for a term of three years. They cannot be revoked, except that for just cause.

The main duties of the statutory auditors consist in the control of the company’s activities and their compliance with the law and the by-laws, as well as in the control that the company is properly managed and that the organizational, administrative, and accounting system of the company is adequate to its actual needs. With this aim, the statutory auditors are entitled to proceed, also on an individual basis, with inspections and controls on the management of the company, and they are also entitled to require information from the directors with respect to specific transactions or to the actual performance of the company.

The statutory auditors are jointly liable with the directors for the facts or omissions carried out by the directors,

provided that the adverse effect or damage caused by such facts or omissions would have not occurred, had they supervised the directors' activities in compliance with their duties.

According to the law, the control on the accounts and on the financial statements of the company, is performed by an external auditor (either an individual professional or a company), exception made for those cases in which the company is not obliged to consolidate its balance sheets. In such cases, in fact, the by-laws of the company may assign such duties to the board of statutory auditors.

### **b.2) The Dualistic System**

In the dualistic system, a relevant part of the corporate governance passes from the shareholders to an independent professional body, namely the surveillance board. On the other hand, the management of the company is entrusted to an administrative board, which shall be composed of at least two members, appointed by the surveillance board. The administrative board is the only body ultimately liable for pursuing the company's purpose and, apart from only few exceptions, it will be governed by the same provisions set forth for the board of directors within the traditional system.

The surveillance board shall be composed of at least three members (among which at least one effective and one substitute member must be enrolled in the professional registrars of auditors), to be appointed upon resolution of the shareholders' meeting. The surveillance board is entitled, on one side, to supervise and control the management of the company (function granted in the traditional system to the board of

auditors), and, on the other side, to exercise most of the functions which in the traditional system are granted to the competence of the shareholders' meeting.

Therefore, the surveillance board shall, inter alia, appoint and revoke the administrative board, determine its remuneration, approve the balance sheets and exercise on behalf of the company any liability actions against the administrative board, or any of its members.

As to the shareholders, the dualistic system substantially limits the extent of their power to the appointment of the surveillance board, as well as to the resolution upon the main guidelines and the general objectives of the company's activities and upon the major material amendments to the company's by-laws or the major events regarding the structure and the life of the company (e.g. dissolution, mergers, de-mergers, change of the corporate form or of the company's stock capital).

Finally, as opposed to the traditional system, any S.p.A. adopting the dualistic system must be subject, without exceptions, to the accounting surveillance of an external auditor.

Based on the above, it can be concluded that, among the three governance systems in exam, the dualistic system achieves the most significant separation between the competence of the beneficial owners of the company and that of its governance bodies. For these reasons, the dualistic system seems to be particularly suitable for those companies in which the administration of the company is to be granted to independent and professional managers with no (or very few)



interferences on the part of the shareholders. On the other side, the dualistic system does not seem to be advisable for small-medium size companies, in which a strong participation of the shareholders in the day to day management of the company is generally registered.

### **b.3) The Monistic System**

The monistic system does not provide for a clear distinction between an administrative body and a surveillance body with duties of control of the management of the company: in fact, both the functions are carried out by the board of directors, although through different bodies established within such board. In fact, the monistic system assigns the management of the company to the board of directors, while the supervision over such management is granted to a different corporate body named the audit committee, to be appointed by the board of directors itself, among its members.

The audit committee is entrusted with all the powers and duties typically assigned to the board of statutory auditors within the traditional system, such as the control of the management of the company and the control of the compliance with the laws and the company's by-laws. Furthermore, as to the accounting control, also in the monistic system such control is not qualified as a duty of the audit committee and shall be exercised by an external auditor.

It is worth being mentioned that, in case of adoption of the monistic system, at least half of the members of the board of directors must meet the independence requirements provided for statutory

auditors by the Italian Civil Code or by the codes of conduct issued by trade associations or by the relevant market management companies.

### **3.1.2 S.r.l. and S.r.l.s.**

The articles of association can establish the precise limits of the competence of each corporate body, with significant differences from company to company. More precisely, the quotaholders shall resolve on any matter referred to them by the law or by the articles of association, as well as on any matter referred to them by the administrative body or by part of the quotaholders. The matters reserved by the law to the exclusive decision of the quotaholders are: (i) the yearly approval of the financial statements and the related decision on profits/losses destination; (ii) the appointment and revocation of the members of the administrative body; and (iii) the amendments of the articles of association (for which a quotaholders' meeting before a notary public is mandatory).

The voting right in S.r.l. and S.r.l.s. is attributed to each member in proportion to its participation in the Company. Such general rule may be derogated by the Bylaws, which may attribute to certain quotaholders an increase of their voting rights (e.g. multiple vote, casting vote), or a limitation to the same (i.e. limited or conditioned vote).

The administrative body is the competent body for the ordinary and extraordinary management of the company, and can be composed of (i) a sole director, (ii) a plurality of directors, with managing powers that can be exercised either jointly or severally or both, or, alternatively (iii) of a board of directors.

No restrictions to the duration and renewability of the office of directors are provided by the law.

Furthermore, the S.r.l. structure grants flexibility also regarding the appointment of the controlling body. The appointment of, alternatively, a sole statutory auditor, a board of statutory auditors, or of an external auditor is not mandatory, unless: (A) the company must consolidate its financial statements; (B) the company controls a company obligated to external audit control; (C) the company exceeds, for two subsequent financial years, at least two of the following minimum financial thresholds: (i) the total assets in the assets and liabilities statement exceed Euro 4.400.000; (ii) the total earnings from sales of goods and services exceed Euro 8.800.000; (iii) the average human resources employed during each financial year exceeds 50 units.

### **3.2 Requirements for local shareholding/directors**

As a preliminary remark, it should be noted that no restriction and/or limitation exists in Italy with respect to foreign investments and in relation to the ownership of Italian companies' equity by foreign investors and business operators.

The same applies to foreign directors.

### **3.3 Minority shareholders' rights and protection**

The minority shareholders' rights and protection are represented by the following instruments.

#### **3.3.1 Right of inspection and control**

##### **i) S.p.A.**

In the S.p.A. the rights and duties of inspection and control are generally reserved to the controlling body.

In addition, the shareholders have the right to report all the facts deemed to be in breach of the company and /or shareholders' interests to the Board of

Auditors that will have to take such facts in consideration in its inspection. If the facts are reported to the Board of auditors by several shareholders representing 1/20 of the company's equity, or 1/50 in case of company admitted to the risk capital market, the Board will have to investigate on such facts, and present its conclusions and proposals to the shareholders' meeting, without delay.

Moreover, the shareholders representing 1/10 of the company's equity, or 1/20 in case of company admitted to the risk capital market, may ask for a judicial inspection and control on the management of the company, in case of grounded suspect of serious irregularity carried out by the administrative body, that may damage the company or one or more controlled companies.

##### **ii) S.r.l.**

Each quotaholder of the S.r.l. has a personal and direct control on the management activity as to them are conferred the rights to: (a) obtain from the directors' information on the management, and (b) examine, also by means of consultants of trust, the corporate books and the documents relating to the management of the company. In case of rejection to grant the right of control or in case such right is thwarted by the directors, the shareholder can obtain appropriate court orders issued as a matter of urgency.

#### **3.3.2 Right to appeal against shareholders' resolutions**

Absent, dissenting, or abstained shareholders - representing 5/100 of the company's equity, or 1/1000 in case of company admitted to the risk capital market for S.p.A. or without thresholds for the S.r.l. (or the different percentage set forth by the company's by-laws) - can appeal before the Court against

assembly resolutions and request their cancellation, in case of non-compliance of the same with the law or the articles of association/by-laws. Same right of appeal is granted in case of (a) missing convocation of the meeting, (b) missing minutes of the meeting, (c) impossible or illicit resolution, (d) resolution modifying the company's object into an impossible or illicit activity.

The shareholders not reaching the above-mentioned thresholds, or not having right of vote, can claim the reimbursement of the damages suffered as a consequence of the illegitimate resolution.

#### **4. Foreign Investment, Thin Capitalization, Residency, and Material Visa Restrictions**

##### **4.1 Any significant barriers to entry for an offshore party**

No specific restriction or barrier are generally provided under the Italian Law for offshore business and investments.

Therefore, to offshore parties are applicable all the requirements generally provided for both Italian and foreign investments, such as the compliance of the company's purpose with the Italian law provisions, compliance with regulation provided for specific activities as, for example, banking, insurance, gold trading, military and defense activities and preliminary issuing of any necessary clearance and administrative authorization.

Some limitations may derive from the application of the state to state reciprocity principle

##### **4.2 Any capitalization obligations**

The minimum capitalization requirement has been described above under the incorporation proceedings paragraph.

Specific rules are provided by the law with regards to the compulsory actions to be taken

in case the financial statement reports losses that absorb the company's equity over a fixed debt/equity ratio.

If as a consequence of losses, the company's capital has diminished by more than one third, the shareholders' meeting must be convened to take the opportune actions.

If the company is not recapitalized, or the loss is not reduced to less than one third within the following fiscal year, the company's capital must be reduced in proportion to the losses that have been ascertained.

If, as a consequence of losses accruing, the capital is reduced below the minimum required, the shareholders' meeting must be immediately convened in order to resolve either the reduction of the capital for losses, and the immediate increase of the capital to an amount not lower than the minimum required, or, the conversion of the company into a structure that is consistent with the existing capitalization, or the winding up of the company.

##### **4.3 Any special business or investment visa issues**

Pursuant to Art. 26 of Law July 25, 1998, nr. 286, the individual who either establishes a commercial, industrial, professional or artisan business in Italy, or is a shareholder of a commercial company or partnership, or is appointed as member of the administrative body of a commercial company, is entitled to be granted a VISA for independent work.

The Visa is issued by the consular authorities competent for the residence of the applicant, provided that; (i) the business activity or the company is duly registered with the competent Corporate Register, is active and in good standing; (ii) the individual has a yearly income higher than the income that qualifies for exemption to the social security contribution (as of today Euro 8.400,00); (iii) the

individual has a suitable and long term residential accommodation in Italy; (iv) a Police clearance is granted.

#### 4.4 Any restrictions on remitting funds out of the jurisdictions (withholdings, etc.)

Fiscal earnings treatment on outgoing capital. Pursuant to Art 27 of the Presidential Decree nr. 600 of 1973, save any different provision contained in applicable international conventions to avoid double taxation, profits distributed by companies having their offices in Italy, to nonresident shareholders are subject to a withholding tax equal to 20%.

Italy has signed with eighty-four countries double taxation conventions, pursuant to which the payment of dividends to a receiver resident in one of those countries (and subject to the receiver of the dividends is the actual beneficial owner) is subject to the maximum withholding tax indicated in the applicable convention, that, on a case by case basis, varies from 5% to 15%.

The provisions above mentioned do not apply to dividends paid to receivers that are income tax payers in EU white listed member states (or in European Economic Area - EEA). Such receivers, pursuant to Art. 3 of Presidential Decree nr. 600 of 1973, are in fact subject to a 1.375% withholding tax.

Pursuant to the so called “Mother-Daughter Directive” (i.e. 435/90/CEE), the distribution of dividends is not subject to any withholding tax, in case the following conditions are met: (i) both payer and receiver are resident in two EU member States; (ii) the stockholding is not lower than 25%; (iii) the Italian company is a S.p.A or a S.r.l. (plus other minor and less used types of company listed in the Directive); (iv) the companies are subject to income taxation; (v) the stockholding belongs to the Mother Company for not less than twelve months.

Specific anti-elusive provisions exist in order to avoid that the Mother company constitutes a fictitious entity that hides the ultimate stockholding of a non-resident entity.

#### 5. Startup entities

By Law no. 221/2012, Italy has been one of the first European countries to adopt a special regulation for Startup entities, aimed to support and facilitate economic activities with a high scientific and technological value.

To benefit from the special Startup regulation, a company must meet the following mandatory requirements:

- to be constituted in the form of a s.p.a., s.r.l., s.a.p.a., cooperative company, European company;
- not derive from the sale of a business entity or a branch of the same;
- to have as exclusive or prevalent corporate purpose the development, the production and the marketing of innovative products or services of high technological value;
- to have its headquarter in Italy;
- not be quoted on a regulated market;
- to prohibit the distribution of profits for a period of four years from the constitution;
- to maintain an annual value of the production not exceeding 5 million Euros.

The above-mentioned company must also have one of the alternative requirements listed below:

- to incur research & development expenditures equal to or greater than 15% of the higher value between cost and total value of the production;
- to have at least 1/3 of the workforce holding a PhD or a degree with a 3-years certified research activity or, alternatively, 2/3 of the workforce holding a Master’s degree;

- to hold as owner or as licensee an industrial patent title (patent, trademark, model, copyright, etc.) relating to the sectors of industry, biotechnology, semiconductors, plant varieties and recorded software.

All companies that meet these requirements may apply for the registration in the special section of the Italian Corporate Register dedicated to Startup companies. In this way, they will benefit from the favorable regulation provided for losses of the share capital under the legal minimum as well as non-submission to insolvency proceedings (except for the composition of the over-indebtedness crisis).

Furthermore, by way of derogation from the general corporate law, the following advantages are extended to Startup constituted in the form of s.r.l.:

- Shareholdings: It is possible to provide for categories of shareholdings with additional rights for the member, also derogating from the principle of proportionality, as well as categories of shareholdings with limited voting rights, excluded or subject to particular conditions.
- Public offers: shareholdings may be offered to the public in the form of financial products, including through the use of online fundraising portals.
- Operations on participations: the related prohibition does not apply, provided that the transaction is carried out for the purpose of incentive plans involving the assignment of shareholdings to employees, directors, service providers - including professional ones -.
- Financial instruments: It is possible to issue financial instruments bearing equity or administrative rights (excluding voting rights) following the services rendered by the members or third parties (including professional consultants).

Additional advantages are provided for tax and contribution purposes, in favor of the company and other persons involved in the Startup:

- For the Company: exemption from paying the stamp duty, the costs of registration to the Corporate Register and the annual right to the Chamber of Commerce; tax credit for the hiring of highly qualified staff.
- For directors, employees, and associates: under certain conditions, employee's income arising from the assignment of participated financial instruments is exempted from direct taxes and contribution duties.
- For external employees or consultants: incomes from the assignment of financial instruments issued in relation to works or services rendered - even of professional nature - are not included in the taxable income.
- For investors: natural persons or companies who invest in the Startup's capital will benefit from an IRPEF deduction or a deduction from the taxable income of the IRES.

In conclusion, it is worth mentioning a recent innovation introduced by Law Decree no. 3 of January 24, 2015, converted in Law no. 33 of March 24, 2015, concerning the Startup constitution.

Following this legislative novelty and the implementing decrees issued by the Ministry of Economic Development, an online wizard - alternative to the ordinary constitution before a Public Notary - can be accessed, which allows the computerization of the constitutive acts of the innovative Startup. However, in order to benefit from this simplification, the following conditions and procedure must be respected:

- the Company must be constituted in the form of s.r.l.;



- the Article of association and the Bylaws must be filled in full compliance with the standard model attached to the ministerial decree;
- the act must be digitally signed by each of the subscribers;
- the digitally signed e-documents (Article of association and Bylaws) must be submitted for the registration to the relevant Corporate Register, within 20 days from the subscription;
- the Corporate Register conducts the conformity checks, after which the Startup is registered in the special section of the Corporate Register.



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# INTERNATIONAL LAWYERS NETWORK



**TARK GRUNTE SUTKIENE  
ESTABLISHING A BUSINESS ENTITY IN LATVIA**

**ILN CORPORATE GROUP**

## ESTABLISHING A BUSINESS ENTITY IN LATVIA

### 1. Types of Business Entities

Foreign investors may choose from the types of business entities:

- Limited liability company
- Joint stock company
- Individual merchant
- General partnership
- Limited liability partnership
- Branch
- Entities under European Law
- Representative office

The most common types of business entities in Latvia are limited liability company and joint stock company.

#### 1.1 Limited liability company

Due to its closed composition of shareholders and simple management structure, limited liability company (in Latvian - "SIA") is the most common type of a company in Latvia. The main reason why most businesses opt for SIA is that the minimum share capital requirement is only EUR 2,800 (and may be even less in certain cases as described below).

Before registration of a limited liability company, amount of share capital not less than 50% of the subscribed share capital, i.e. at least EUR 1,400, shall be paid in full. The rest amount of subscribed share capital shall be paid up within a period of 1 year after registration of the company.

If the share capital of a limited liability company amounts to at least EUR 2,800, then it can be paid-up by money or property contributions. Items of property contributions may be tangible or intangible property valued in terms of money, which may be used in the commercial activities of a company, except for property which in accordance with the law may not be the subject of collection. If the share capital is paid up by

property contributions, a document certifying the value of each property contribution item is necessary. Property contributions must be evaluated and an opinion must be provided by a person, who is included in the list of valuers approved by the Register of Enterprises. If the total value of property contributions does not exceed EUR 5,700, and the property contributions together are less than one-half of the share capital, then the valuation of the property contributions and the submission of an opinion may be made by the founders themselves. In such case, all founders will have to sign the opinion.

Additionally, as an incentive to start up business, there is a possibility to establish a SIA with minimised share capital (the minimum share capital is EUR 1). In such case the number of founders may not exceed 5 private individuals, one or several whereof simultaneously serve as the management board members. Furthermore, the founders may not be shareholders of another SIA with minimised share capital. If the share capital is less than EUR 2,800, only monetary investment can be made into the share capital.

SIA may be owned by one or more individuals or legal entities. The list of the shareholders of SIA is publicly available to third parties.

The administrative bodies of SIA are the meeting of shareholders, the management board and the supervisory board (NB! SIA is not obliged to have a supervisory board, but the shareholders may establish one, if they wish so). The supervisory board, if established, shall consist of at least 3 members; the maximum number of supervisory board members is 20. The management board shall consist of at least 1 member. Members of the management board and the supervisory board may not be the same persons.

#### 1.2 Joint stock company

A joint stock company (in Latvian - "AS") is a type of company more suitable for a larger number of shareholders, and its administrative structure is

stricter than in case of SIA. AS may be established as a public or private company. In case of a public AS its shares may be publicly traded.

The minimum share capital of a joint stock company is EUR 35,000. Before the submission of the registration application the amount of the paid-up share capital may not be less than the said minimum equity capital or less than 25% of the subscribed equity capital (if the share capital is larger than the minimum).

Shares of AS are securities and may exist in a form of registered shares of bearer shares. Registered shares are registered by the management board in the register of shareholders. Bearer shares, in their turn, are registered in the financial instrument account by the Latvian Central Depository.

AS may be owned by one or more individuals or legal entities. In contrast to SIA, the list of the shareholders of AS is not publicly available to third parties.

The administrative structure of AS is three-tier: a general meeting of shareholders, a supervisory board and a management board. The supervisory board shall consist of at least 3 members and at least of 5 members if the shares of AS are publicly traded; the maximum number of supervisory board members is 20. The management board shall consist of at least 1 member. Members of the management board and the supervisory board may not be the same persons. There are no requirements for their place of residence.

## 2. Steps and Timing for Establishing a Company

There are two options for becoming a shareholder of a company, namely, buying shares of an already existing company or establishing a new one. To establish a new company (in the context of the most common business entities - SIA and AS) the founders must take the following steps:

- Sign a memorandum of association among them (in case of a sole shareholder this

document is replaced by a decision) and develop the articles of association of the company;

- Set up the administrative institutions of the company;
- Open a temporary bank account in the name of the company to be founded, pay up share capital and receive a notice from the bank confirming the amount of the paid-up share capital;
- Organise the valuation of property contributions (if such is provided for);
- Pay the State fee for entering in the Commercial Register (EUR 150,00 for SIA and EUR 350,00 for AS) and the payment for the publication concerning making of the entry in the Register (EUR 27.03)

Sign and apply to the Register of Enterprises together with other documents (such as memorandum of association, articles of association, consents of the management and supervisory board members, notice from the bank, management board notice on the registered address, register of shareholders (for SIA only), consent of the immovable property owner to the registration of the registered address, document confirming payments of the state and publication fees, etc.).

When the Company is registered with the Register of Enterprises, the management board must change the temporary bank account to a fully functioning current bank account and register signature rights with the respective bank.

Where appropriate, the company is obliged to reveal to the bank and the Register of Enterprises its beneficial owners (private individuals).

All documents in foreign languages must be translated into Latvian and the translation must be notarised. In some cases, documents regarding a foreign company or individual establishing a



business entity in Latvia also must be apostilled or legalised.

Companies are usually registered within three business days from submission of respective documents to the Register of Enterprises; however, it is also possible to pay a state fee in triple amount to speed up the registration procedure and to register a business entity within one business day.

### **3. Governance, Regulation and Ongoing Maintenance**

#### **3.1 Corporate Governance**

Members of the management and supervisory boards must be private individuals with active legal capacity. They are required to perform their obligations with the diligence of an honest and careful manager and to be loyal to the company.

The management board is the legal representative of the company (i.e., the executive body). Only management board is entitled to represent the company in relations with third parties and act on behalf of the company. If there are several members in the management board, then the management decisions must be taken by all the management board members jointly. However, the representation (signature) rights may be joint (i.e., all or several management board members together must represent the company) or individual (i.e., each management board member is entitled to represent the company). The representation rights are set by the shareholders in the articles of association.

The supervisory board, in its turn, is the supervisory body of the company, which represents the shareholders during the time periods between the meetings of shareholders and supervises the activities of the management within the scope specified in the Commercial Law and the articles of association. It may be specified in the articles of association that the management board is obliged to require the consent of the supervisory board to decide on issues of major importance. However, the

supervisory board may not decide on issues, which are within the competence of the management board.

Members of a management or supervisory board who cause losses to the company due to non-fulfilment of their duties (e.g. by breaching their duty of care) are jointly and severally liable to the company. A member of the management or supervisory board will not suffer liability, if he or she acts pursuant to a lawful resolution of the general meeting or any other competent body or if he or she proves that he or she performed his or her obligations with due diligence. A claim for payment of compensation to the company for damage may also be submitted by a creditor of the company if the assets of the company are not sufficient to satisfy the claims of the creditor.

A shareholder is not liable for the liabilities of the company and vice versa. If the shareholders adopt a resolution on a matter that would normally be in the capacity of the management or supervisory boards, they may be liable as if they were members of the management or supervisory board.

Additionally, a person, who influences a member of a management or supervisory board to act in a manner that is contrary to the interests of the company, may be liable for compensation damages.

#### **3.2 Reporting requirements**

During their commercial activity, companies must comply with certain reporting requirements. For instance, the majority of the corporate changes (such as change of the registered address, changes in the composition of the management and supervisory boards, change of company name, etc.) must be registered with the Register of Enterprises within a certain period of time determined in the Commercial Law.

Furthermore, after the end of the accounting year, the management board of the company is obliged to compile an annual account of the company. The annual report must be further approved by



the meeting of shareholders and then submitted electronically to the State Revenue Service together with an auditor's report, if compulsory.

### 3.3 Requirements for local shareholding / directors

There are no particular requirements for the shareholders of a company (unless it is considered a financial institution) in respect of their legal form or nationality. Namely, any local or foreign legal entity or private individual may become a shareholder of a company.

There are also no particular requirements for the management or supervisory board members (except for the management and supervisory boards of financial institutions) in respect of their nationality, education, experience, place of residence, etc. However, only private individuals with the capacity to act may become the members of a management or supervisory boards.

### 3.4 Protection of minority shareholders

The rights of shareholders mostly depend on the number of shares owned by the shareholder. However, the Commercial Law also provides for the minority shareholder protection rules, according to which some of the most important minority shareholder rights are as follows:

- Shareholders who represent not less than 5% of the share capital with voting rights have the right, within one year from the date of registration of the company, to request that the Register of Enterprises approves one or several experts selected by the shareholders to perform an examination of the founding of the company;
- Shareholders that represent not less than 10% of the share capital, may, during a meeting of shareholders or no later than two months after the meeting of shareholders, raise substantiated objections to the elected auditor;
- Shareholders that represent at least 10% of the share capital have the right to request postponing approval of an annual account, disputing the correctness of separate positions in the annual account;
- Shareholders, who represent not less than 5% of the equity capital, may request the conduct of an internal audit, if there is a substantiated reason for that;
- Shareholders of SIA, who represent not less than 10% of the share capital may request convocation of the shareholder meeting;
- Shareholders of AS, who represent not less than 5% of the share capital may request convocation of an extraordinary shareholder meeting;
- Shareholders, who represent not less than 5% of the share capital may request bringing an action against management and supervisory board members, founders and the auditor;
- Shareholders, who represent at least 5% of the share capital may request the institution convening the shareholders' meeting of AS to include additional issues in the agenda of the meeting;
- Each shareholder has the right to request the court to declare the decision of a shareholder void, if such decision or procedure for taking it is in contradiction to law or the articles of association, or a significant violation has been allowed in the convening of the shareholders' meeting or the taking of the decision;
- Each shareholder, who does not agree to the reorganization rights, may request the acquiring company to redeem shares for money.

Shareholders may conclude a shareholder agreement, regulating the relationship among them (NB! Such agreement is optional, does not have to be submitted to the Register of

Enterprises and thus is not publicly available to third parties), including but not limited to the agreement on voting in the shareholders' meeting. Such agreement of shareholders may include various provisions beneficial for minority shareholders. Provisions protecting the rights of the minority shareholders may also be provided for in the articles of association of a company.

#### 4. Foreign Investment, Thin Capitalization, Residency and Material Visa Restrictions

##### 4.1. Thin Capitalization rule

Taxable income is the income reported in a company's profit and loss statements, prepared and adjusted in accordance with the Latvian laws.

For corporate income tax purposes, companies may not deduct interest expenses that exceed the lower of the following amounts:

- an amount equal to the average amount of liabilities multiplied by the annual weighted average interest rate for loans issued to domestic non-financial companies (calculated based on statistical indicators of monetary financial institutions), which is multiplied by a coefficient of 1.57. The annual weighted average interest rate for loans issued to domestic non-financial companies is published on the website of the Bank of Latvia within a month after the end of a tax period.
- the actual amount of the interest divided by a coefficient C. Coefficient C is calculated using the following formula:

$$C = \frac{D}{(E - R) \times 4}$$

- the values of the items in the formula are the following:

D = average liabilities

E = total equity

R = amounts in long-term revaluation reserve and similar reserves that have not resulted from profit distributions.

The thin-capitalization rules do not apply to interest on loans obtained from the specific credit institutions specialising in the loans for business development e.g.:

- credit institutions that are residents of the EU, European Economic Area (EEA) or a country with which Latvia has entered into a double tax treaty
- Latvian Treasury
- European Bank for Reconstruction and Development
- World Bank Group, etc.

The second calculation described above for calculating the limitation on the interest deduction does not apply if the loans are obtained from financial institutions (defined in the Credit Institution Law) that are resident in the EU, EEA or a country which Latvia has entered into a double tax treaty with and if such financial institution provides crediting or financial leasing services and is under the supervision of credit institutions or the financial monitoring agency.

The thin-capitalization rules do not apply to credit institutions and insurance companies.

The amount of interest that exceeds the deductible amount may not be used to reduce taxable income in future tax years.

It should be noted that new corporate income tax regulation which will implement new corporate income tax calculation and payment principles, including thin-capitalization rules, will become effective as from 1 January 2018 and will be applicable for financial year 2018.

##### 4.2. Related-parties' transactions

Latvian law requires the arm's-length principle to be followed in all related-party transactions (that is, by applying fair market prices). The tax authorities may reassess transactions between

related parties and recalculate the tax base if the prices applied in related-party transactions are not fair market prices.

The following transfer pricing methods: the comparable uncontrolled price, resale price, cost-plus, profit-split and transactional net margin methods, may be used to assess whether the prices applied in controlled transactions are consistent with the arm's-length principle.

Latvian taxpayers with annual net turnover exceeding EUR 1,430,000 are required to prepare transfer pricing documentation containing industry, company, functional and economic analysis. The documentation requirements apply to all related-party transactions with an annual value over EUR 14,300. The generally accepted practice for transfer pricing issues is based on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

Taxpayers can enter into an advance pricing agreement (APA) with the tax administration on the establishment of an arm's-length price for a transaction conducted with a related foreign company if planned transaction annual value exceeds EUR 1,430,000.

In case a taxpayer complies with an APA, the tax administration during a tax review may not adjust the arm's-length price established for the transaction.

#### 4.3. Permanent establishment

It shall be considered that a non-resident (foreign merchant) has a permanent establishment in Latvia if all the following conditions are met:

- 1) the non-resident (foreign merchant) uses a fixed place of business in Latvia;
- 2) the place of business is used permanently or has been established for the purpose of being utilised permanently;
- 3) the place of business is used for carrying on a business.

A place of management, a branch, a factory, a workshop and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources are considered fixed places of business.

Providing consultancy, management or technical services will create a permanent establishment if the services are provided for the period totally exceeding 30 days in any consecutive six-month period (unless a double tax treaty states otherwise).

Non-resident companies operating through a permanent establishment in Latvia are subject to tax on income derived by the permanent establishment in Latvia as well as on income independently derived abroad by the permanent establishment. If a non-resident company engages directly in business activities in Latvia that are like the business activities performed by its permanent establishment or subsidiary in Latvia, income derived from the non-resident company's activities is included in the taxable income of the permanent establishment or the subsidiary.

#### 4.4. Withholding taxes

Latvia has concluded 59 double tax treaties (DTT), which provide favourable withholding tax rates on payments made by entities also outside European Union. Most of the DTT ensures that withholding tax levied by the subsidiary does not exceed 5% on dividend payments provided that Latvian company owns at least 25% of capital of another company. The withholding tax rate on interest payments made to Latvian company shall not exceed 10% based on provisions of DTT, while withholding tax on royalties is limited to 10%.

No withholding tax is levied on dividends paid by Latvian company to non-residents. However, this rule does not apply for dividend payments to companies established in tax havens; these dividends would be taxed with Corporate Income Tax of 15% rate.

No withholding tax shall be applied for Latvian company's interest and royalties paid to foreign

companies, excluding the ones made in tax havens territory.

Withholding tax of 10% is levied on management and consulting fees. It is possible to obtain exemption from 10% withholding tax under the provisions of DTTs, provided that certain administrative procedure is complied with before making the payment.

If not provided differently under DTT, 5% withholding tax is levied on payments for the use of property (both movable and immovable) situated in Latvia.

2% withholding is levied on non-resident's income from disposal of real estate located in Latvia. A Latvian company is obliged to deduct the withholding tax, while no withholding tax should be applied on disposal of real estate, when both contracting parties are non-residents.

Under Latvian law if real estate constitutes more than 50% of company's assets (at the beginning of the financial year) it is considered as the disposal of real estate and therefore attracts 2% withholding tax.

#### 4.5. Further corporate tax exemptions

Full tax exemptions for dividends and profit of share distributions paid to a Latvian entity shall be applied. However, this rule does not apply if company which shares are distributed is established in tax havens.

#### 4.6. Harmonization with EU tax legislation

In relation to the accession of the Latvian Republic to the EU on 1 May 2004 EU Directives concerning direct taxation (income taxation) were incorporated into the ITA.

Based on the so-called Parent Subsidiary Directive (and related amending Directives), dividends and other profit share distributions between Latvian and EU companies which meet the definition of a parent company and its subsidiary are not subject to corporate income tax. To qualify as parent and

subsidiary companies, companies must fulfil the following conditions:

- the companies must take a legal form listed in the respective EU Directives,
- the minimum capital holding in the subsidiary is 10% and is held by the parent company for an uninterrupted period of at least 12 months (can be fulfilled subsequently),
- the companies must be EU member state tax residents,
- the companies must be subject to corporate income tax as stated in the respective EU Directives.

Similar conditions also apply if dividends are paid by a Latvian subsidiary to its mother company if it is a tax resident of the EU or Switzerland.

Latvia is a member of the OECD since 1 July 2016.

#### 4.7 Residency and visas

Latvia is a member of the European Union and it is a Schengen country. The basic rules regarding EU and non-EU nationals are as follows:

##### 4.7.1 Citizens of the European Union

Citizens of European Union, persons from the member states of the European Economic Area and the Swiss Confederation (Union citizens) have the right to enter and stay in Latvia based on a valid travel document.

Union citizens may enter Latvia without a visa and stay in Latvia for up to 90 days within a six-month period, counting from the day of entry. If a Union citizen wishes to stay for a period exceeding 90 days, counting from the day of entry, the citizen shall register with the Office of Citizenship and Migration Affairs (OCMA) and shall receive a registration certificate. The registration is not required if the citizen stays up to six months annually, if the aim is to establish employment relationship or a person is employed in Latvia, but actually resides in another member state, where

he or she returns at least once a week, or a person is a student in one of the Latvian educational institutions and his expected stay in Latvia shall not exceed one year.

Union citizens have rights to acquire permanent residence permits, if they have continuously legally resided for a period of five years.

#### 4.7.2 Visa Requirements

Citizens of certain countries may enter Latvia without a visa and stay for a period 90 days within a six-month period. A list of these countries may be found at <http://www.pmlp.gov.lv/en/home/services/visas-and-invitations/>. If a visa is required, generally the visa applicant must apply to the appropriate Latvian embassy or consulate in person.

The application package normally includes a valid travel document, a visa application form filled out and signed, a photo, a copy of a document confirming that the applicant has a health insurance policy, document conforming that the applicant has financial means of subsistence (usually an extract from a bank account signed by a representative of the bank), documents verifying the reason for entry and the anticipated place of residence, or documents indicating that a letter of invitation has been approved by the OCMA (the invitation is valid for six months from the date of approval), a receipt confirming the fee payment. A state duty of between EUR 35 - 85, depending on the type of the visa, must be also paid. Visas may be issued for a single, double or multiple entries and for transit. A transit visa entitles a person to stay in Latvia for a period not exceeding three days. A short-term visa entitles a person to stay in Schengen area for up to 90 days within a six-month period, counting from the day of entry. However, if a person wishes to stay for a longer period, a long-term visa shall be acquired.

#### 4.7.3 Residence Permits

A residence permit is not required to own a business; it is possible to apply for a temporary residence permit to operate a business. In any

case a residence permit is necessary if the person wishes to reside in Latvia for a period of time exceeding 90 days within a six-month period counting from the first day of entrance.

Such temporary residence permit may be issued to a foreigner who is registered as an individual business person, is self-employed, or is registered as a management board member, supervisory board member, procura holder, representative of a branch or representative office of a foreign merchant, if the undertaking is performing active activity and its activity provides economic benefit for Latvia or promotes the development of economy of Latvia.

A residence permit may be issued to a foreigner, if the person has made a payment in the amount of EUR 10,000 to the state budget and has invested EUR 100,000 in the share capital of a capital company, which employs more than 50 employees, the yearly turn-over of which or annual report (balance sheet) is more than EUR 10,000,000 or has made a payment in the amount of EUR 10,000 to the state budget and has invested no less than EUR 50,000 in the share capital of a capital company, which employs no more than 50 employees, the yearly turn-over of which or annual report (balance sheet) is less than EUR 10,000,000 (during such investment in the share capital, a residence permit may be acquired by no more than 10 foreigners), or if the person has acquired or owns one or several real properties with the transaction value of EUR 250,000, provided that all statutory conditions are met. A residence permit may be issued to a foreigner who has made a financial investment in a credit institution of no less than EUR 280,000 in the subordinated capital and has made a payment in the amount of EUR 25,000 to the state budget, the term for such investment must be at least five years. A foreigner may also apply for a residence permit, if he/she has purchased interest-free state securities in the amount of EUR 250,000 and has made a payment in the amount of EUR 38,000 to the state budget. Foreigners who



intend to create or develop an innovative product can apply for residence permit for up to 3 years, if within three months after receiving the residence permit the foreigner will be registered as the board member of a capital company and qualified venture capital investor shall make investment in the share capital of the same company in amount of EUR 30 000 within 6 months after issuance of residence permit and at least EUR 60 00 shall be invested within 18 months of issuance of temporary residence permit.

Consequently, a temporary residence permit may be exchanged to a permanent residence permit by a foreigner who has continuously resided on the grounds of a temporary residence permit for at least five years in Latvia.

Persons from countries of the visa regime with Latvia may apply for a residence permit in the respective Latvian embassy or consulate in person.

#### 4.7.4 Work Permits

If a Union citizen or his or her family members have established employment relationship or are self-employed in Latvia, no work permit is required. All other persons must obtain a work permit in such cases, which would include also a foreign person, who engages in operational management of a Latvian company. In the latter case, the entry "Business" in a person's visa or the entry "Commercial activity" in a residence permit confirms the existence of a work permit and it is not required to process a separate work permit.

A work permit is issued to a foreigner by the OCMA based on a visa or residence permit. If a business person wishes to employ a foreigner on the grounds of an employment agreement, a vacancy shall be announced in the Employment State Agency at least one month before applying for visa or residency permit. If it is intended to engage the foreigner on the grounds of a service agreement, no vacancy shall be announced.

A work permit shall not be required if a foreigner is lawfully staying in the Republic of Latvia in relation to:

- 1) performance on tour (concert on tour) as a creative artist or performing artist, or as an administrative or technical worker involved in ensuring of the performances (concerts) and the intended length of stay in the Republic of Latvia does not exceed 14 days;
- 2) an invitation from an educational institution or scientific institution, or individual scientist for conducting of scientific research or participation in the implementation of educational programs and the intended length of stay in the Republic of Latvia does not exceed 14 days;
- 3) performing of scientific activity in accordance with a scientific co-operation agreement, which has been concluded with a scientific institution included in the Register of Scientific Institutions of the Republic of Latvia;
- 4) being a crew member of the ship, which performs international voyages and is registered in the Latvian Ship Register;
- 5) being a crew member of a vehicle, which performs international voyages and is registered in a foreign state;
- 6) being lawfully employed in another European Union Member State, Member State of the European Economic Area or in the Swiss Confederation and the employer appoints him or her for provision of services in Latvia for a period not exceeding 90 days within six months;
- 7) being an individual merchant registered in the Commercial Register, a member of the board of directors or council, a procurator holder, an administrator, a liquidator or a member of a partnership who has the right to represent the partnership, or a person who is authorised to represent a merchant (foreign merchant) in activities related to the branch, or a self-employed person, and the duration of stay does not exceed 90 days within six months;

- 8) being an employee that has been transferred within the company (employee working for company that is registered outside the EU and sends its workers to a company which concludes commercial activity in Republic of Latvia) and whose stay in Republic of Latvia does not exceed 90 days in any 180-day period and has a valid temporary residence permit issued by another EU member state;
- 9) the fact that he/she is employed in the Republic of Latvia and his/her stay in Latvia does not exceed 14 days in any 180-day period.



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# INTERNATIONAL LAWYERS NETWORK



**TGS BALTIC**

**ESTABLISHING A BUSINESS ENTITY IN LITHUANIA**

**ILN CORPORATE GROUP**



## ESTABLISHING A BUSINESS ENTITY IN LITHUANIA

### 1. Types of business entities

Investors may choose from the following types of business entities:

- Private limited liability company
- Public limited liability company
- Individual enterprise
- Limited partnership
- General partnership
- Small business
- Cooperative
- Agricultural company
- Branch or Representative office

The most common types of business for foreign investors in Lithuania are public and private limited liability companies and branch or representative office.

#### 1.1 Public and Private limited company

Public limited liability company (“akcine bendrove” or “AB”) and private limited liability company (“uzdaroji akcine bendrove” or “UAB”) are the most common types of companies in Lithuania. In the beginning of 2017, there were more than 119,975 UAB and over 412 AB registered in the Register of Legal persons.

The main differences between UAB and AB:

- capital requirements: the minimum share capital requirement for UAB is only EUR 2,500, whereas for AB it is EUR 25,000;
- auditing: AB must always have an auditor for the carrying out of the audit of its annual financial statements. An UAB must have an auditor when it is established in its articles of association or if required by law. For example, the applicable law foresees that the annual

financial statements of UAB shall be audited, if at least two of the following three criteria are met: net sales revenue during the reporting financial year exceeds EUR 3.5 m. asset balance value exceeds EUR 1.8 m. average annual number of employees exceeds 50. The auditor is elected and his remuneration is set by the shareholders of the company;

- bodies of the company: the head of the company shall always be elected in UAB and AB. The board (collegiate management body) is not a mandatory body in UAB, whereas in AB at least one collegiate body shall be formed;
- public trade of shares and bonds: AB can be listed in a stock exchange and sell its securities publicly, whereas UAB cannot be listed.

A licence / permit may be required for certain regulated areas of activities. For instance, companies engaged in businesses such as insurance, banking, pharmacy, construction, transportation, etc. must obtain licences/permits. In certain cases, those licences/permits are either issued before the establishment of a company (i.e. its registration in the Register of Legal Persons) or before the actual commencement of activities. Also, permits / consents may be required upon carrying of certain corporate actions of the licensed companies, for example, upon increase of the capital, initiation of merger, transfer of shares, etc.

#### 1.2 Branch or Representative Office

A branch and Representative Office, although it can be registered in the Republic of Lithuania, are not considered as legal persons. A branch is a structural subdivision of the legal person, having its own registered office and performing all or part of the functions of legal person.





Representative Office is a subdivision of a legal person, having its own registered office and having a right to perform some actions on behalf of the legal person. Legal person assumes all obligations of branch or representative office.

A branch and Representative Office performs their activities under the regulations approved by the legal person.

A branch or Representative Office is established upon the decision of the founder (legal person) to establish a branch or a representative office. Also, statutes of a branch or representative office shall be prepared.

There is no requirement under Lithuanian law regarding a branch's or representative office's registered capital.

## 2. Steps and Timing to Establish

Generally, a company is established in two steps: (i) adopting foundation documents and (ii) registering the company in the Register of Legal Persons.

Considering only the most common corporate structures for foreign investors (AB and UAB), the following main steps to establish a company are:

- making an interim name reservation (if so decided);
- signing of an Act of Incorporation (or Agreement of Incorporation, in case there are several founders). The Act of Incorporation of UAB may also incorporate the decision of the founder(s) regarding election of management bodies;
- obtaining a consent of the owner for premises wherein the company shall be domiciled;
- opening of an accumulation account at a bank;
- transferring of initial contributions to the accumulation account (always not less than EUR 2,500);

- signing of the Articles of Association;
- drafting of a Report on Establishment of a Company (only in case of AB);
- convening of a Founders' Meeting; electing of the management bodies (always in case of AB and with respect to UAB – If such decision is not taken upon signature of an Act of Incorporation or Agreement);
- preparing data of shareholders' list for Legal Entities Information System (JADIS) (in case of UAB);
- notarizing the establishment documents at the notary;
- registration of documents with the Register of Legal Persons.

Please note that in case the founder of a company is a foreigner, in all cases documents of the founder should be submitted to the notary (extract from the foreign register, in which the date of the legal person is stored and copy of articles of association of the legal person). Such documents must be officially certified and either apostilled or legalized and translated into Lithuanian language.

To establish a branch or representative office in Lithuania, the following main steps must be taken:

- making an interim name reservation (if so decided);
- adoption of a decision by a competent body of the founder to establish a branch or representative office in Lithuania, to appoint a manager of a branch or representative office;
- obtaining a consent of the owner for premises wherein a branch or representative office shall be domiciled;
- preparation and approval of regulations of the branch or representative office by a competent body of a founder;





- notarizing the establishment documents at the notary;
- registration of documents with the Register of Legal Persons.

In addition to the above-mentioned documents of the foreign founder the annual financial statements for the last financial year must be submitted to the Register of Legal Persons in case of establishment of a branch or representative office by a foreign company (officially certified and either apostilled or legalized and translated into Lithuanian language).

The registration of a company or a branch takes up to 3 business days as of submission of all documents to the Register of Legal Persons.

As of relatively the law provides a possibility to register UAB on-line. However, there are certain requirements that must be met: only the natural person may be the founder, the founder must have a qualified e-signature, the articles of association and the act of incorporation of UAB are to be of the form approved by the Government, the name of UAB must be reserved and not include a word "Lithuania" in it, there must be a sole founder, the premises whereat UAB shall be registered must be solely owned by the founder and not arrested and the authorized capital (in case of UAB) must be paid by monetary contributions.

### **3. Governance, Regulation and Ongoing Maintenance**

#### **3.1 Corporate Governance**

Members of the management board must be natural persons and members of supervisory board may be natural or legal persons. The members of the management board must act in good faith and reasonable manner in respect of the company and members of other bodies of it. Furthermore, they must be loyal to the company and maintain confidentiality. Every candidate to the position of the management board or supervisory board member must

inform the electing body where and what position he holds, how his other activities are connected to the company and to other legal persons related to the company.

The manager of the company shall be a single-person management body of the company. The manager must be a natural person. Every candidate for the office of the manager of the company must also inform the electing body where and what position he/she holds, how the other activities are connected to the company and to other legal persons related to the company.

The company is represented by the manager of it. However, there may be a rule of quantitative representation established in the articles of association the company, whereas the company may be represented by more than one person, acting together.

According to it, the manager of the company must in all cases act on behalf of the company together with the member(s) of the management board.

The management board member and the manager of the company who fails to perform or performs improperly his duties set in laws or incorporation documents (e.g. duty of confidentiality, care) must redress all damage incurred on the company. The member of the management body of the company who has concluded the contract overstepping his authority shall also take on subsidiary liability where a company fails to satisfy fully the claim of a third person, arising of such a contract.

#### **3.2 Reporting requirements**

The set of annual financial statements of a company together with the annual report of the company and the auditor's report (if compulsory) must be submitted to the Register of Legal Persons not later than within 30 days after the annual general meeting of shareholders of the company (it must be held



within 4 months from the close of the financial year of the company).

### 3.3 Requirements for local shareholding / directors

For shareholders, there are no specific requirements. In respect of their nationality, they may be either Lithuanian or a foreign individual or company.

The applicable law does not provide for any specific educational requirements for the director and members of the board, except for the requirement that they must be natural persons.

Regarding to employment of the Manager from foreign countries please refer to the Article 4.4.

### 3.4 Protection of minority shareholders

The legislation of the Republic of Lithuania does not provide any exceptional rights for minority shareholders. The rights of shareholders depend on the number of shares owned by the shareholder.

Legal acts grant several rights for protection of minority shareholders, such as:

- the right to take an action for declaring the decisions of a company's bodies invalid, within 30 days of the day when the plaintiff found out or should have found out about the contested decision;
- company must at a shareholder's written request and not later than within seven days from the receipt of the request, grant the access to and (or) submit to him copies of particular documents related to company (such as articles of association of the company, annual and interim financial statements, minutes of the general meetings of shareholders, etc.). The shareholder or a group of shareholders owning or holding 1/2 and more of the company's shares having undertaken a written obligation set by

the company not to disclose trade secrets shall have access to all documents of the company;

- shareholder or a group of shareholders owning not less than 1/10 of the company's shares has a right to initiate investigation of company's activity. Shareholders shall enjoy the right to request the court to appoint experts who must investigate whether a legal person or legal person's managing bodies or their members acted in a proper way;
- shareholder or a group of shareholders owning not less than 1/3 of the company's shares has a right to force sale of shares of a legal person's member whose actions contradict the goals of legal person's activities and where there are no grounds to expect any changes in the said actions;
- shareholders owning not less than 1/10 of the company's shares has a right to initiate the convocation of general meeting of shareholders (Articles of Association of the company may establish a smaller number of shares);
- shareholders owning not less than 1/20 of the company's shares has a right to propose questions for the general meeting of shareholders;

Please note that shareholders of a legal person may conclude a shareholders' agreement, regulating relationships of shareholders of the company, including but not limited to the agreement on voting in the general meeting of shareholders. Such an agreement of shareholders may include various provisions beneficial for minority shareholders.

There is also a possibility to establish a protection for minority shareholders in the establishment documents of the company as well as in the agreements of shareholders.



## 4. Foreign Investment, Thin Capitalization, Residency and Material Visa Restrictions

### 4.1 Taxation

#### 4.1.1. Thin Capitalization rule

Thin capitalization ratio is 1:4. Interest and currency exchange loss on the capital borrowed from the controlling creditor, which exceeds the equity of the company more than 4 times, are non-deductible for corporate income tax purposes.

The controlling creditor is the one who:

- directly or indirectly holds more than 50% of shares or rights (options) to dividends; or
- together with related parties, holds more than 50% of shares or rights (options) to dividends, and the holding of that creditor is not less than 10%.

#### 4.1.2. Related-parties' transactions

Transfer pricing (TP) rules apply to transactions between a Lithuanian resident company and a person associated with the resident company (a controlled transaction). If the price of a controlled transaction differs from the market value of the above transaction (arm's length transaction), corporate income tax (CIT) shall be imposed on the amount which the Lithuanian resident company would have received as income or the amount which the Lithuanian resident company would not have incurred as expenses if the transfer price had conformed to the market value of the transaction.

The Lithuanian company (or a permanent establishment of a foreign company) must prepare and have the transfer pricing documentation when its annual sales exceed EUR 2,896,200.

The Lithuanian tax authorities apply the transfer pricing methods which basically follow the OECD Transfer Pricing Guidelines

for Multinational Enterprises and Tax Administrations. These are:

- Comparable Uncontrolled Price (CUP) method - compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction. If there is any difference in prices, this may be that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.
- Resale price method - the resale price margin (i.e. the gross margin) that the reseller earns from the controlled transaction is compared with the gross margin from comparable uncontrolled transactions.
- Cost plus method - the mark-up on costs that the manufacturer or service provider earns from the controlled transaction is compared with the mark-up on costs from comparable uncontrolled transactions.
- The transactional net margin method - compares the net profit arising from controlled and uncontrolled transactions (after relevant operating expenses have been deducted) instead of comparing a gross profit on resale or gross mark up on costs.
- The transactional profit split method - splits the combined profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated between independent enterprises.
- Combination of the above methods.



### 4.1.3. Permanent establishment

A permanent establishment of a foreign entity in Lithuania is subject to CIT at 15% rate.

A foreign entity is deemed as operating through its permanent establishment in

Lithuania if its activities comply with the following two criteria:

- its activities are not temporary;
- a commercial cycle of operations has been finished.

Activities of a foreign entity are considered temporary in the Republic of Lithuania if they last up to six months.

A completed cycle of commercial operations consists of three stages of operations carried by a foreign entity:

- stage one covers one or several of the following operations: marketing, including market analysis, distribution, advertising, design, and exploration works and other essentially similar operations;
- stage two covers one or several of the following operations: warehousing, consulting, acceptance of orders, scientific research, experimental, development and technological work, production, provision of services and other essentially similar operations;
- stage three several of the following operations: selling, supply, delivery, payment (remuneration) and other essentially similar operations.

If the activity of a foreign entity is not temporary, the cycle of commercial operations has not been completed but the stage of performed activity is considered as an independent activity of a foreign entity (or its part), such a foreign entity may also be deemed having a permanent establishment in Lithuania.

The second condition, based on which it is established whether a foreign entity performs its activities in Lithuania through its permanent establishment, is a representative/agent through which the activity is performed, i.e. a foreign entity is considered to be performing activities through its permanent establishment if it performs its activities in Lithuania through a dependent agent/representative.

The third condition, based on which it is established whether a foreign entity performs its activities in Lithuania through its permanent establishment, is a construction site, a construction, assembly, or equipment facility used by a foreign entity in Lithuania.

The fourth condition, on the basis of which it is established whether or not a foreign entity performs its activities in Lithuania through its permanent establishment, is the use of equipment or structures for prospecting or extraction of natural resources in Lithuania, i.e. a foreign entity is deemed to perform activities through its permanent establishment in Lithuania if it uses equipment or structures for prospecting or extraction of natural resources, including the wells or vessels used for that purpose.

### 4.1.4. Withholding taxes

#### Dividends

15% withholding tax is applied on dividends paid by a Lithuanian company to a foreign company.

Full participation exemption applies dividends if the recipient foreign company has held at least 10% of the voting shares in the distributing Lithuanian company continuously for at least 12 months. The participation exemption does not apply to dividends paid to foreign companies registered or organized in listed tax havens; also, it does not apply to dividends which are being paid to foreign companies if their main goal or the main



object is to get tax benefit, which conflicts with the Council Directive 2011/96/EU.

Interest

Interest paid to foreign companies is generally subject to a 10% withholding tax.

No withholding tax is applied on interest paid to companies resident in EEA countries or countries having an income tax treaty with Lithuania.

Other exemptions include to interest on government securities issued in the international markets, deposit interest and interest on subordinated loans meeting the criteria prescribed by the Bank of Lithuania.

Royalties

Royalties paid to foreign companies are subject to a 10% withholding tax.

No withholding tax is applied on royalties' payments if the recipient is an associated company of the paying company and is resident in another EU Member State. Two companies are "associated companies" if (i) one of them holds directly at least 25% of the capital of the other or (ii) a third EU company holds directly at least 25% of the capital of the two companies. A minimum holding period is 2 years.

Other income

Income from sale or lease of immovable property located in Lithuania is subject to a withholding tax at a rate of 15%. Reassessment on a net basis is available upon request.

15% withholding tax applies to income paid to non-residents (including companies) for entertainment and sports activities performed in Lithuania, as well as to payments to the members of the supervisory council. Reassessment on a net basis is available upon request for entertainment and sports activities.

Capital gains received by foreign entities otherwise than through its permanent establishment are not subject to withholding tax in Lithuania.

**4.1.5. Corporate Income Tax**

Resident companies and permanent establishments of the foreign entities (including branches) in Lithuania are subject to corporate income tax on the worldwide income.

Permanent establishments of non-resident companies are subject of corporate income tax principally on the same grounds as resident companies.

The general corporate income tax is 15%.

A small company is subject to a reduced corporate income tax rate of 5% if its average number of employees does not exceed ten persons, and its taxable income during the taxable period is less than EUR 300,000.

Ordinary losses of up to 70% of taxable income of the taxable period may be carried forward indefinitely. Capital losses may be carried forward for 5 years to be offset against future capital gains.

Tax losses can be also transferred from one company to another within the same group of companies and within the same tax period, if certain conditions are met.

**4.1.6. Further corporate tax exemptions**

For the corporate taxpayers who have been implementing the investment projects (e.g. acquisition of fixed assets such as machinery and equipment, trucks and trailers, computer hardware and software, communication equipment and acquired rights) the taxable profit may be reduced up to 50%.

R&D costs may be deducted in a triple amount in the taxable period when they are incurred.





Companies established in the free economic zones with capital investments of not less than EUR 1,000,000 and which meet certain other conditions are exempt from corporate income tax for the first 6 years following the date of the capital investments and they are subject to a 50% reduction in CIT rate for 10 subsequent years.

Also, Companies established in the free economic zones with capital investments of not less than EUR 100,000, which average number of employees is not less than 20 in financial years, and which meet other certain other conditions are exempt from corporate income tax for the first 6 years following the date of the capital investments and they are subject to a 50% reduction in CIT rate for 10 subsequent years.

#### 4.2 Taxation of Non-Residents

The income tax base of non-resident individuals is worldwide income derived through a fixed base maintained in Lithuania, if any, and the following types of income from the Lithuanian sources:

- employment income;
- distributed profits, including dividends;
- any payments made to members of the management board or the supervisory council;
- interest;
- royalties;
- income from leasing of immovable property located in Lithuania;
- income from the disposal of immovable property located in Lithuania or movable property that is subject to mandatory registration in Lithuania;
- income from sports and entertainment activities; and

- compensation for violation of copyright or similar rights.

The general flat rate of personal income tax is 15%.

#### 4.3 Harmonization with EU tax legislation

The Lithuanian tax system is harmonized with EU tax legislation.

#### 4.4 Residency and visas

Lithuania is a member of the European Union and it is a Schengen country. The basic rules regarding EU and non-EU nationals are as follows:

##### 4.4.1 Citizens of the European Union

A citizen of the EU and his family members may enter and stay in the Republic of Lithuania upon a valid travel or identity document for a period of three months starting from the first day of entry. A citizen of the EU arriving to Lithuania for a period exceeding three months within a half a year and meeting at least one of the grounds specified in the Law on the Legal Status of Foreigners (e.g. to work) shall be issued a certificate of the form established by the Minister of the Interior. The certificate shall be valid for a period of five years (or a shorter period requested by the foreigner). The family members of the EU citizens who are not EU citizens shall be issued EU residence permits valid for the period of the EU citizen's certificate but in any case, for no longer than five years.

A citizen of EU who has been lawfully residing in the Republic of Lithuania for the last five years shall acquire the right of permanent residence in the Republic of Lithuania. Absence from Lithuania for more than six months within a year may constitute grounds for refusing the right of permanent residence, except in cases where absence is caused due to serious reasons. The acquired right of permanent residence in the Republic of



Lithuania shall be lost upon departure from the country for a period exceeding two consecutive years or gain the permanent resident status in other EU state.

The above requirements shall be also applicable with respect to the citizens of European Free Trade Association.

#### 4.4.2 Visa Requirements

Citizens of certain countries may enter Lithuania without a visa. A list of these countries may be found at [www.migracija.lt](http://www.migracija.lt) or [www.urm.lt](http://www.urm.lt).

Visa types are a Schengen visa and a national visa. Schengen visas may be single-entry, dual-entry and multiple-entry visas. National visas shall be single-entry (issued to an alien who has been granted a temporary or permanent residence permit to formalize the permit) and multiple-entry visas (issued, for example, to students, artists, sportsmen, employees, etc.).

Documents for the issuance of a visa are to be submitted to a diplomatic mission or a consular post of the Republic of Lithuania abroad or in certain cases to a diplomatic mission or a consular post of another Schengen State representing the Republic of Lithuania abroad.

#### 4.4.3 Residence Permits

In the Republic of Lithuania, a foreigner could get the temporary or permanent residence permit to live in the Republic of Lithuania. The temporary and permanent residence permit is issued to a foreigner who is a citizen of a non-EU Member State.

The temporary residence permit to live in the Republic of Lithuania may be issued for a period of one to three years, depending on the grounds of issuance of the temporary residence permit, among them employment, owning a business and studying.

The permanent residence permit may be issued among other grounds after living for 5 years in the Republic of Lithuania with the temporary residence permit, subject to passing the Lithuanian language exam and the exam of the basics of the Lithuanian Constitution. The permanent residence permit is valid for a maximum period of 5 years. After this period, the permit shall be replaced.

In general, a foreigner of a non-EU Member State must also obtain a work permit to be issued under a separate procedure when applying for the temporary residence permit to live in the Republic of Lithuania on the grounds of employment. The work permit is not necessary in certain cases including those when such foreigner establishes a company, becomes a co-owner of it and becomes a Manager, Board member or Supervisory Board member or has not less than 1/3 of the shares of the company. The company should meet the special requirements: (i) the company must operate at least six months; (ii) the company has at least 3 employees who are citizens of the Republic of Lithuania or has permanent residence permit to live in the Republic of Lithuania; (iii) owned capital of the company must be not less than EUR 28,000 and the foreigner's invested part should be not less than EUR 14,000.

An application for the issuance of an initial temporary residence permit must be submitted to a diplomatic mission or a consular post of the Republic of Lithuania abroad, and a foreigner who is lawfully staying in the Republic of Lithuania must submit the application to a migration office of a territorial police agency in the territory of which he intends to reside. Same applies when lodging an application for the replacement of a temporary residence permit.

The application for the issuance of the first temporary residence permit must be considered not later than within four months



from the lodging of the application with a relevant institution (exceptions are applied for high qualified employees, startup founders or shareholder who invested not less than EUR 260,000), whereas an application for the replacement of a temporary residence permit – not later than within two months from the lodging of the application, with abovementioned exceptions.

The decision to issue a temporary residence permit is valid for three months, accordingly, after adoption of a particular decision it is necessary to apply to the territorial police agency personally to formalise a temporary residence permit.



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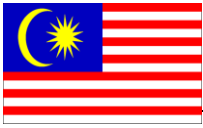


# INTERNATIONAL LAWYERS NETWORK



**ANAD & NORAINI**  
**ESTABLISHING A BUSINESS ENTITY IN MALAYSIA**

**ILN CORPORATE GROUP**



## ESTABLISHING A BUSINESS ENTITY IN MALAYSIA

### **Methods of conducting business in Malaysia**

In Malaysia, business may be conducted in the following manner: -

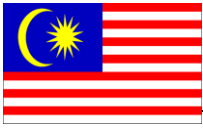
- (a) by an individual operating as a sole proprietor; or
- (b) by two or more (but not more than 20) persons in partnership; or
- (c) by a limited liability partnership (LLP); or
- (d) by a locally incorporated company or by a foreign company registered under the Companies Act, 2016 (“Act”). A company is a legal entity separate from its members or shareholders. The shareholders cannot be held liable for the debts of a company unless they personally guarantee the debts or loans of the company. According to the Act, a company must be registered with the Companies Commission of Malaysia (“CCM”) to engage in any business activity.

For the purpose of this paper, we will focus on the fourth method of conducting business in Malaysia, i.e. by way of incorporation of a local company or a foreign company. At the time of writing, the Companies Act, 1965 (the “1965 Act”) has been repealed and replaced by the Act, which has adopted recommendations from the Corporate Law Reform Committee and the Accounting Issues Consultative Committee (both established by the CCM), as well as other regulatory authorities and professional bodies. The new legal framework under the Act aims at making the corporate vehicle more attractive for businesses by deregulating certain aspects of the corporate processes, reducing the cost of doing business, simplifying compliance provisions, providing flexibility in managing the affairs of companies while enhancing internal control, corporate governance, and corporate responsibility.

Amongst the important changes introduced by the Act include:

- (a) the introduction of a single director and single shareholder company for private companies. In the event office of sole director or last remaining director becomes vacant due to death, disqualification or otherwise vacation of office, the company secretary is responsible to call for a meeting of next of kin or personal representatives for the purposes of appointing new director. If a new director is not appointed within 6 months, the Registrar of Companies may direct to strike the company off the register.
- (b) the replacement of memorandum and articles of association with a constitution (which is optional).
- (c) the optional use of common seal.
- (d) no par or nominal value for new shares issued.
- (e) the removal of the requirement to state authorised share capital.
- (f) the removal of mandatory requirement for private companies to hold annual general meetings.
- (g) private company may pass members’ resolution by way of written resolution in lieu of meetings. The passing of the resolution need not be unanimous.
- (h) new alternative procedures for the reduction of capital through solvency statements instead of a court order.
- (i) increased sanctions on directors for breaches under the Act, which include heavier fines and longer terms of imprisonment.
- (j) the introduction of two new corporate rescue mechanisms, Corporate Voluntary





Arrangement and Judicial Management, to help financially distressed companies remain as a going concern and avoid winding-up.

### **Classification of Companies**

#### **(A) Limited and unlimited companies**

As a separate legal entity, a company's own liability for its debts is never limited and it must pay off all the debts it owes to its creditors. However, the liability of the members in respect of the debts of the company may be limited or unlimited. The question of the members' liability only becomes relevant if the company goes into liquidation and that its debts cannot be fully discharged out of its assets.

Under the Act, three (3) types of companies are allowed to be incorporated, namely:

- (a) a company limited by shares;
- (b) a company limited by guarantee; or
- (c) an unlimited company.

A company limited by shares is a company formed on the principle that the member's liability is limited to the amount (if any) unpaid on the shares taken up by them<sup>1</sup>. If the member has paid in full for his shares, he cannot be asked to pay more and creditors cannot go after the members' personal assets. This is the most common company structure in Malaysia.

A company limited by guarantee is a company where the liability of the members is limited to such amount as the members undertake to contribute in the event the company is wound up<sup>2</sup>. Companies limited by guarantee are not usually trading companies and they are usually confined in practice to organisations that want the advantages of incorporation without

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<sup>1</sup> see section 10 (2) of the Act.

<sup>2</sup> see section 10 (3) of the Act.

necessarily wanting to engage in business. According to section 45 (1) of the Act, a company limited by guarantee is a company which is formed with any one or all of the following objects: -

- (a) providing recreation or amusement;
- (b) promoting commerce and industry;
- (c) promoting art;
- (d) promoting science;
- (e) promoting religion;
- (f) promoting charity;
- (g) promoting pension or superannuation schemes; or
- (h) promoting any other object useful for the community.

According to section 11 (2) of the Act, a company limited by guarantee shall be a public company.

An unlimited company is a company formed on the principle of having no limit placed on the liability of its members, i.e. the liability of members to contribute to the assets of the company on winding-up is not limited<sup>3</sup>. According to section 11 (3) of the Act, an unlimited company shall either be a private or a public company.

#### **(B) Public and private companies**

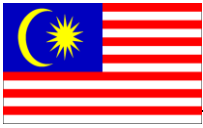
A company with a share capital (whether limited or unlimited) may be incorporated either as a private limited company or a public limited company. Under the Act, a private company is defined as<sup>4</sup>:-

- (a) any company which immediately prior to the commencement of the Act was a private company under the repealed written laws;

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<sup>3</sup> see section 10 (4) of the Act.

<sup>4</sup> see section 2 of the Act.



(b) any company incorporated as a private company under the Act; or

(c) any company converted into a private company pursuant to section 41 of the Act,

being a company, which has not ceased to be a private company under section 42 of the Act.

The requirements of a private company limited by shares are as follows<sup>5</sup>:-

(i) it shall have not more than 50 shareholders. In determining the number of shareholders in a private company, the joint holders of shares shall be considered as one person and an employee who is a shareholder shall not be counted;

(ii) it shall restrict the right to transfer its shares;

(iii) it shall not offer any shares or debentures of the company to the public;

(iv) it shall not allot or agree to allot any shares or debentures of the company with a view to offering such securities to the public; and

(v) it shall not invite the public to deposit money with the company for fixed periods or payable at call, whether bearing interest or otherwise.

A public company is simply defined as a company other than a private company<sup>6</sup>. Apart from the mode of incorporation, a public company may also be formed via the conversion from a private company by passing a special resolution lodged with the CCM by altering its name to include "Sendirian Berhad" or "Sdn. Bhd.". The lodgement shall also include a statement in lieu of prospectus and a statutory declaration verifying

that section 190 (2)(b) of the Act has been complied with<sup>7</sup>.

A public company can apply to have its shares quoted on the Bursa Malaysia (stock exchange) subject to compliance with the requirements set out by the exchange. Thereafter, any subsequent issue of securities (by way of rights or bonus or issue arising from an acquisition, etc.) would require the approval of the Securities Commission.

### (C) Foreign companies

Foreign companies generally refer to companies incorporated outside Malaysia but set up places of business within Malaysia, or carry on businesses in Malaysia. According to the Act, "foreign company" is defined as<sup>8</sup>:-

(a) a company, corporation, society, association, or other body incorporated outside Malaysia; or

(b) an unincorporated society, association, or other body which under the law of its place of origin may sue or be sued, or hold property in the name of the secretary or other officer of the body or association duly appointed for that purpose and which does not have its head office or principal place of business in Malaysia.

In view of the foregoing, whether an entity is a "foreign company" depends essentially on the law of the place of its origin. It is also noteworthy that certain unincorporated associations may be treated as foreign companies under the Malaysian law if they can sue or be sued, or hold property. Thus, a partnership registered in England may possibly be considered a foreign company in Malaysia.

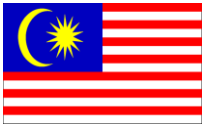
A foreign company cannot carry on business in Malaysia unless the company is registered as a

<sup>5</sup> see section 42 and 43 (1) of the Act.

<sup>6</sup> see section 2 of the Act.

<sup>7</sup> section 41 (2) of the Act.

<sup>8</sup> section 2 of the Act.



foreign company with the Registrar of Companies<sup>9</sup>. The term “carrying on business” includes establishing or using a share transfer or share registration office or administering, managing, or otherwise dealing with property situated in Malaysia as an agent, legal personal representative, or trustee, whether by servants or agents or otherwise.

### **Representative/Regional Offices**

In addition to the above, a representative office or a regional office may also be set up by a foreign company / organisation in Malaysia to perform permissible activities for its head office / principal. The major difference between a local company and a representative/regional office is no commercial transaction is allowed for the latter.

The setting up of a representative / regional office would allow foreign-based companies to have a presence in Malaysia for at least three (3) years to explore business opportunities in Malaysia to ascertain if Malaysia is the right place for them to start business. The approval for duration of establishment of representative/regional office will be a minimum of two (2) years, depending on the merits of each case.

A regional office is an office of a foreign company / organisation that serves as the coordination centre for the company’s / organisation’s affiliates, subsidiaries and agents in South-East Asia and the Asia Pacific. The regional office established is responsible for the designated activities of the company / organisation within the region it operates.

The representative office or regional office does not undertake any commercial activities and only represents its head office / principal to undertake designated functions. Although the

representative office / regional office is not required to be incorporated under the Act, the setting up of a representative / regional office requires the approval of the Government of Malaysia.

The following are the activities which may be performed by the approved representative / regional office for its head office or principal: -

- gathering and analysis of important information or undertaking feasibility studies on investment and business opportunities in Malaysia and the region;
- planning of business activities;
- identifying sources of raw materials, components, or other industrial products;
- undertake research and product development;
- act as a coordination centre for the corporation’s affiliates, subsidiaries, and agents in the region; and
- other activities which will not result directly in actual commercial transactions.

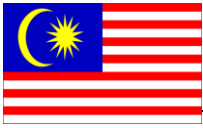
An approved representative / regional office may not carry out the following activities: -

- be engaged in any trading (including import and export), business or any form of commercial activity;
- lease warehousing facilities - any shipment / transshipment or storage of goods shall be handled by a local agent or distributor;
- sign business contracts on behalf of the foreign corporation or provide services for a fee;
- participate in the daily management of any of its subsidiaries, affiliates, or branches in Malaysia.

The proposed operational expenditure of the representative / regional office must be at least

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<sup>9</sup> section 561 (1) of the Act.



RM300,000 per annum and must be completely funded from sources outside Malaysia by their head office. No tax will be imposed on the representative / regional office.

### **Procedure of incorporating a local company**

To incorporate a company, the applicant is required to apply to CCM to confirm the availability of the proposed company name. The application will be approved if the name is not one which may be refused on any ground in section 26 (1) of the Act<sup>10</sup> and the proposed name will be reserved for thirty (30) days from the date of lodgement of the application together with the prescribed fee<sup>11</sup>.

Once the name is approved and reserved, the applicant is required to lodge an application for incorporation to the CCM, which shall include a statement by every person who intends to form a company containing the following particulars<sup>12</sup>:-

1. the name of the proposed company;
2. the status of whether the company is private or public;
3. the nature of business of the proposed company;
4. the proposed address of the registered office of the proposed company;
5. the name, identification, nationality, and the ordinary place of residence of every person who is to be a member of the company and where any of these persons is a body corporate, the corporate name, place of incorporation, registration number

<sup>10</sup> The proposed name can be approved if it is not (i) undesirable or unacceptable; (ii) identical to an existing company, corporation, or business; (iii) identical to a name that is being reserved under the Act; or (iv) a name that the Minister has directed the Registrar of Companies not to accept for registration.

<sup>11</sup> section 27 (5) of the Act.

<sup>12</sup> section 14 (3) of the Act.

and the registered office of the body corporate;

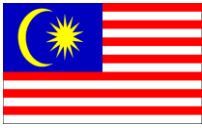
6. the name, identification, nationality, and the principal place of residence of every person who is to be a director;
7. the name, identification, nationality, and the principal place of residence of the secretary, if any;
8. in the case of a company limited by shares, the details of class and number of shares to be taken by a member;
9. in the case of a company limited by guarantee, the amount up to which the member undertakes to contribute to the assets of the company in the event of its being wound up; and
10. any other information as the Registrar of Company may require.

The said application shall also be accompanied by a statement from each promoter or director confirming<sup>13</sup>:

- (a) his consent to act as a promoter or his appointment as a director, as the case may be; and
- (b) that he is not disqualified under the Act to act as a promoter or a director, as the case may be.

If the Registrar of Company is satisfied that the requirements of the Act have been complied with, the Registrar shall enter the particulars of the company in the register, assign a registration number to the company and issue a notice of registration in the form and manner as he may determine. The notice of registration is conclusive evidence that the company is duly registered under the Act.

<sup>13</sup> section 14 (4) of the Act.



As seen above, the multiple and various types of incorporation documents required under the 1965 Act such as the memorandum and articles of association, statement of compliance and statutory declaration by each promoter and first directors of the proposed company are no longer required and the process of incorporation has been very much simplified under the Act.

A company incorporated under the Act is a body corporate and shall have legal personality separate from that of its members<sup>14</sup>, and shall be capable of exercising all the functions of a body corporate and have the full capacity to carry on or undertake any business or activities, including to sue, and be sued, to acquire, hold or dispose of any property and to do any act which it may do or to enter into transactions<sup>15</sup>.

#### **Requirements of a locally incorporated company**

A locally incorporated company must maintain a registered office in Malaysia where all books and documents required under the Act are kept.

The secretary of the company must be a natural person of full age and a citizen or permanent resident of Malaysia, who shall ordinarily reside in Malaysia by having a principal place of residence in Malaysia. He must be a member of a prescribed body or is licensed by the Registrar of Companies. The company must also appoint an approved company auditor to be the company auditor in Malaysia.

Under the Act, a private company shall have a minimum of one (1) director while a public company shall have a minimum of two (2) directors<sup>16</sup>. The minimum number of directors excludes alternate or substitute director and is required to satisfy the following criteria by proving that the director(s):

- (a) is/are ordinarily resident in Malaysia<sup>17</sup>; and
- (b) has/have a principal place of residence in Malaysia.

A director of the company need not necessarily be a shareholder of the company.

A company cannot deal with its own shares or hold shares in its holding company. By virtue of section 123 (1) of the Act, a company cannot give any financial assistance, whether directly or indirectly and whether by means of a loan, guarantee for the purpose of a purchase or subscription by any person of or for any shares in the company, or any shares in its holding company.

#### **Registration procedures in respect of foreign companies**

For the purpose of registration, the foreign company shall provide to CCM the following information<sup>18</sup>:-

- (a) the name, identification, nationality, and the ordinary place of residence of every shareholder in Malaysia and, if any of these persons is a body corporate, the corporate name, place of incorporation or place of origin, registration number and the registered office of the body corporate;
- (b) the name, identification, nationality, and the ordinary place of residence of every person who is appointed as a director of the foreign company in Malaysia;
- (c) the list of its shareholders or members at its place of origin;
- (d) in the case of a foreign company with share capital, the details of class and number of shares at its place of origin;

<sup>14</sup> section 20 of the Act.

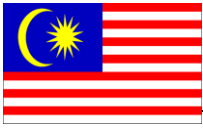
<sup>15</sup> section 21 (1) of the Act.

<sup>16</sup> section 196 (1) of the Act.

<sup>17</sup> the 1965 Act did not focus on the residency requirement as long as the minimum number of director has his principal or only place of residence within Malaysia.

<sup>18</sup> section 562 (1) of the Act.





- (e) in the case of a foreign company limited without share capital, the amount up to which the member undertakes to contribute to the assets of the foreign company at its place of origin in the event of it being wound up;
- (f) the name and address of a person who is a resident in Malaysia, who is appointed by the foreign company as its agent under a memorandum of appointment or power of attorney; and
- (g) such other information that the CCM may require.

Further, the Act requires an agent of a foreign company to lodge a statement confirming his consent for the appointment<sup>19</sup>.

Upon compliance with the requirements under the Act by the lodgement of the prescribed information with the agent's statement of consent to the appointment and the prescribed fee, CCM will register the foreign company and allocate a registration number for the foreign company and issue a notification of registration which shall be conclusive evidence that the requirements as to registration have been complied with. A foreign company shall only be registered under the name as registered in its place of origin subject to the name being available under section 26 of the Act<sup>20</sup>.

Once a foreign company is registered, it shall have the power to hold any immovable property in Malaysia, subject to any written law.

Foreigners are advised to seek further advice from an advocate and solicitor or a practising company secretary for further assistance.

### **Company Tax**

A company, whether resident or not, is assessable on income accrued in or derived from Malaysia. Income derived from sources outside Malaysia and remitted by a resident company is exempted from tax, except in the case of the banking and insurance business, and sea and air transport undertakings. A company is considered a resident in Malaysia if the control and management of its affairs are exercised in Malaysia.

For the year of assessment 2017, resident companies with a paid-up capital of RM2.5 million and below at the beginning of the basis period for a year of assessment are subject to a corporate income tax rate of 18% on the first RM500,000.00 of chargeable income. For chargeable income in excess of RM500,000.00, the corporate income tax rate is 24%. For resident companies with paid-up capital more than RM2.5 million and non-resident companies<sup>21</sup>, the corporate tax rate is 24%.

### **Incentives**

In Malaysia, tax incentives, both direct and indirect, are provided for in the Promotion of Investments Act, 1986, Income Tax Act, 1967, Customs Act, 1967, Sales Tax Act, 1972, Excise Act, 1976 and Free Zones Act, 1990. These statutes cover investments in the manufacturing, agriculture, tourism (including hotel) and approved services sectors as well as research and

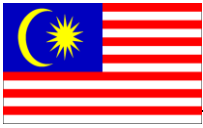
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<sup>19</sup> section 562 (2) of the Act.

<sup>20</sup> i.e. it must not be undesirable or unacceptable or identical to an existing company, corporation, or business or identical to a name that is being reserved under the Act or of a name which the Minister has directed the CCM not to accept for registration.

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<sup>21</sup> Companies with more than 50% of the shareholdings owned by foreigners are deemed to be "non-resident companies". Non-resident companies are liable to Malaysian tax when it carries on a business through a permanent establishment in Malaysia and assessable on income accruing in or derived from Malaysia.



development, training, and environmental protection activities.

The direct tax incentives grant partial or total relief from income tax payment for a specified period, while indirect tax incentives are in the form of exemptions from import duty, sales tax, and excise duty.

For further details, please refer to the website of Malaysian Investment Development Authority at [www.mida.gov.my](http://www.mida.gov.my).

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# INTERNATIONAL LAWYERS NETWORK



MARTÍNEZ, ALGABA, DE HARO & CURIEL, S.C.  
ESTABLISHING A BUSINESS ENTITY IN MEXICO



## ESTABLISHING A BUSINESS ENTITY IN MEXICO

### **Preface**

Martinez, Algaba, De Haro y Curiel, S.C., is a leading law firm in Mexico, committed to provide the highest standard of professional legal counsel and representation. Established in 1969, the firm is comprised of a highly experienced and qualified team of professionals in the diverse areas of law practiced by the firm. The firm's offices are based in Mexico City and in Monterrey, Nuevo Leon, the second largest and most important industrial city in Mexico.

Our firm is reputed to be one of the few law firms in Mexico that offers first class litigation services, encompassing virtually every aspect of commercial, civil and administrative legal procedures, including domestic and international arbitration, as well as a consulting legal area in matters related to corporate, financial, regulatory, real estate, energy and communications.

This combination of practice areas and fields of expertise allows our firm to render enhanced legal advice, a result of the synergy and collective experience of our trial and consultant lawyers that grants our clients a competitive advantage hard to match by any law firm in Mexico.

### **I. General Overview**

As of 2015, Mexico has a population of 119,520,753 according to the Mexican National Institute of Statistics and Geography (*Instituto Nacional de Estadística y Geografía*). Covers a land area of 1,964,375 square kilometers (1,220,606 square miles) and its official language is Spanish.

In matters of political division, Mexico is a Federal Republic formed by 32 states,

including Mexico City. The government in Mexico is divided into three branches: (i) executive; (ii) legislative; and (iii) judicial. Each one of such branches has specific authorities granted by the Mexican Constitution. The President of Mexico leads the executive branch; the legislative branch is divided in federal and local legislative powers and their attributions are to promulgate, discuss and, in its case, issue laws and regulations; and the judicial branch is formed by federal and local courts who are in charge of enforcing the laws.

Currently, Mexico is considered the second largest economy in Latin America. According to the World Bank's Doing Business 2017 Report, Mexico stands in position 47 under the overall "ease of doing business" category, surpassing countries like Brazil (123), Chile (57), India (130) and China (78).

### **II. Types of Business Entities**

For foreign corporations or individuals who seek to do business in Mexico, there are several ways for them to invest their capital in this country. As in many other jurisdictions, a very common vehicle for doing business in Mexico is through the incorporation of a Mexican company, where foreigners may own and participate in their capital stock.

Unlike several other countries including the United States of America ("US"), in Mexico, the legal provisions governing the incorporation of companies are of Federal nature, which means that regardless of the place of incorporation within the Mexican Republic, companies are regulated by the Mexican General Law of



Business Corporations (*Ley General de Sociedades Mercantiles*) (“LGSM”); provided that we will also refer to other type of entities regulated by the Mexican Securities Law (*Ley del Mercado de Valores*) (“LMV”), which is also Federal.

Please be noted that, with a sole exception<sup>22</sup>, the concept of single-shareholder corporations is not allowed under Mexican law.

A. Mexican General Law of Business Corporations (LGSM)

The LGSM regulates six different types of business entities, which can be incorporated either as variable capital companies or not. Considering the fact that the Mexican Income Tax Law (*Ley del Impuesto sobre la Renta*) (“LISR”) grants the same tax treatment to such six types of entities, corporate practice has only left two of them as the most common choice used by foreign investors for doing business in Mexico:

- (i) the variable capital limited liability stock corporation (*sociedad anónima de capital variable*) (“SA”); and
- (ii) the non-stock variable capital limited liability corporation

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<sup>22</sup> Simplified stock corporation (*sociedad por acciones simplificada*) (“SAS”), which is a recently created type of entity regulated pursuant to the LGSM, that is allowed to be incorporated by an individual single-shareholder (no entities allowed as shareholders). Nevertheless, this type of entity is not recommended for foreign investment purposes, since its main purpose is to regulate small and medium businesses, its shareholders may not have any equity participation in any other Mexican entity that allows them to control such entity, and the corporation’s annual total income shall not exceed the equivalent to \$5 million Pesos (approximately \$280,700.00 Dollars).

(*sociedad de responsabilidad limitada de capital variable*) (“SRL”).

1. The SA

(i) Structure

The SA has been widely used in Mexico as an investment vehicle. It has a capital stock divided into shares, where the shareholders’ liability is generally limited to the full payment of their capital contributions. The stock capital must be incorporated with a minimum of two shareholders (either corporations or individuals) and a limited minimum aggregate capital contribution, which is represented always by shares. The SA may issue shares without par value. If it adopts the “variable capital” modality, which is almost always the recommendation, the variable part of the capital is unlimited.

(ii) Agreements among Shareholders

Pursuant to recent amendments made to the LGSM, the SA can be considered as a very flexible vehicle since now you can incorporate in its by-laws all of the shareholders agreements that were not permitted before such amendments entered into effect.

Some examples of the provisions now permitted to be incorporated in the by-laws of an SA are:

- (a) Restriction with respect to the transfer of shares of a same series or class representing its capital stock;
- (b) Exclusion causes for shareholders or the exercise of retirement or





separation rights, or the right to redeem shares, as well as to establish the price of the shares or the method to determine such price;

- (c) Issuance of shares that (i) do not confer voting rights or limit such voting rights, (ii) grant non-economic rights or specifically grant only voting rights; (iii) limit or broaden the economic rights, or (iv) grant veto rights;
- (d) Implementation of mechanisms to be followed in the event of shareholders disagreements with respect to specific matters;
- (e) Broadening, limiting or denying their preemptive rights in the event of capital stock increases, or even providing for publicity methods other than the ones provided in the LGSM;
- (f) Liability limitations for damages and losses arising from directors' or officers' actions in connection with the breach of the "duty of care" of such directors; and
- (g) Stock options to buy or sell shares ("put" or "call" options including "tag along" or "drag along" rights) or agreements to restrict, transfer or regulate the preemptive rights for capital stock increases, among the same shareholders or with third parties; and agreements to exercise voting rights in shareholders' meetings.

(iii) Minority Rights

Regarding minority rights, the SA shareholders representing twenty-five percent (25%) of the shares of

the capital stock with voting rights will have the right to appoint a member to the board of directors.

Similarly, the shareholders representing twenty-five percent (25%) of the shares representing the capital stock with voting rights of an SA may file a civil liability action in court against the directors in the benefit of the corporation pursuant to the terms of the LGSM.

(iv) Liability

In addition to the full payment of their capital contributions, the shareholders, directors and even officers of an SA will be jointly and severally liable for tax purposes when the SA:

- (a) Did not obtain from the Mexican Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*) ("SHCP") through the Tax Administration Service (*Servicio de Administración Tributaria*) ("SAT") a tax identification number ("RFC" or "*Registro Federal de Contribuyentes*");
- (b) Modifies its address for tax purposes while being subject to a tax revision by the SAT;
- (c) Did not record its earnings or if it destroys or modifies accounting documents of the SA; and
- (d) Ends or interrupts its activities without prior notice to the SAT.

Furthermore, pursuant to recent amendments made to the Mexican Bankruptcy Law (*Ley de Concursos Mercantiles*) shareholders, directors and subsidiaries of an SA may also be liable in



frauds against third parties carried out by the SA.

## 2. The SRL

### (i) Equity Structure

The capital of an SRL is divided into participation units. Evidence of participation as a partner reside in an equity participation registry, which shall be recorded in the company's equity participation ledger (no physical title exists) and may only be transferred with the approval of the other partners.

In the SRL, each partner has the right to own only one equity participation and each equity participation can have different values. Equity participations without par value are not allowed nor provided for in the LGSM.

Due to US tax legislation (known as "Check-the-box" Regulations), the SRL, has been used in Mexico for tax benefits of US parent companies, since it can be consolidated for accounting and tax purposes with US holding companies. This way, the organization has limited responsibility and pays taxes as a Mexican corporation, but it is considered, for tax purposes as a partnership in the US. We would strongly suggest that the above be confirmed by a US tax expert.

### (ii) Transmission of the partner status

In the SRL, capital increase requires the approval of the other partners and the acceptance of a new partner requires a special quorum. As a general rule, such special quorum requires the vote of the majority holders of the equity participations, unless a higher quorum is established in the by-laws of the SRL.

### (iii) Number of partners

The SRL may have a maximum of fifty partners and a minimum of two. Therefore, the SRL structure may not be used nor allowed for an initial public offering through the Mexican Stock Exchange.

## B. Mexican Securities Law (LMV)

The LMV regulates three different types of stock exchange companies:

- (i) the investment promotion corporation (*sociedad anónima promotora de inversión*) ("SAPI");
- (ii) the stock market investment promotion corporation (*sociedad anónima promotora de inversión bursátil*) ("SAPIB"); and
- (iii) the stock market corporation (*sociedad anónima bursátil*) ("SAB")<sup>23</sup>.

Pursuant to the LMV, the SAPI is not subject to the supervision of the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*) ("CNBV") (which is the commission in charge of supervising public offering of stock in the Mexican Stock Exchange (*Bolsa Mexicana de Valores*)), except when its capital stock or the securities that represent its capital stock are intended to be publicly traded and be registered in the National Securities and Intermediaries Registry (*Registro Nacional de Valores*) ("RNV"). According to the LMV, SAPIBs and SABs, shall request the registry of the securities that represent their capital stock in the RNV. The LMV has a strict policy stating that, all

<sup>23</sup> The SAPIB and SAB are considered as "Public Companies" pursuant to the LMV.



securities placed in the Mexican Stock Exchange shall be first registered in the RNV and approved by the CNBV.

Mexican legislators created the companies abovementioned to encourage its participation in the Mexican Stock Exchange and created special regulations in order to maintain a controlled public offering of securities including stock or shares of a corporation. It is important to note that, according to the LMV, the abovementioned companies must follow the same incorporation process established in the LGSM for the SA.

### 1. The SAPI

The SAPI is a corporate regime that used to contain several exceptions to the applicable regime for corporations according to the LGSM (no longer due to the recent amendments made to the LGSM). This corporate regime can be used in Mexico for corporations who intend to modify its structure from private entities to Public Companies. A SAPI may be initially incorporated as such or, as an SA and may adopt such modality later on; in such case, it shall have the favorable vote of the majority of its shareholders through an extraordinary shareholders' meeting. The SAPI may provide in its by-laws the same agreements and provisions as provided in the SA.

Furthermore, the SAPI is a more flexible vehicle legally located "in-between" an ordinary corporation regulated pursuant to the LGSM and what the LMV calls a Public Company, in other words, a company which stock is publicly traded. Pursuant to the LMV, the SAPI has the possibility to list its shares in the RNV within a 10-year transition period, or before such term, if the amount of its

capital stock at the end of the fiscal year exceeds an amount equivalent in Pesos<sup>24</sup> to 250 million UDIS<sup>25</sup> (approximately \$81,330,306.00<sup>26</sup> Dollars<sup>27</sup>), which allows the company to gradually adopt corporate governance practices, disclose policies and protect minority rights required for Public Companies to the LMV.

In addition to the above, the CNBV, from time to time, will issue through official communications, general guidelines that will contain additional requirements and conditions that SAPIs will also need to comply in order to become Public Companies.

### 2. Main differences between SAPI and SA

#### (i) Management

The management of a SAPI shall be entrusted to a board of directors and they may adopt for their management and surveillance, the regime contemplated by the LMV for Public Companies, except for the independence requirement for certain board members, which will not be mandatory in this case. In the event that the SAPI elects such regime, the general manager (CEO equivalent), as well as the board of directors will be subject to the provisions set forth under the LMV for such officers which are applicable to Public Companies regarding matters such as

<sup>24</sup> "Pesos" legal currency of Mexico.

<sup>25</sup> "UDIS" Mexican investment units, equivalent to \$5.193971 Pesos, as of August 2017.

<sup>26</sup> Exchange Rate of \$17.81 Pesos for \$1.00 Dollar, as of August 2017.

<sup>27</sup> "Dollars" legal currency of US.



organization, tasks, and responsibilities. If they do not elect such regime, then they will be subject to the general provisions of the LGSM.

The SAPI that elects the LMV regime will not be subject to appoint a statutory examiner (*comisario*); however, it will need to have an independent external auditor and an auditing committee that carries out the examiner's functions.

It is important to mention that, pursuant to the LGSM, the management of an SA can be entrusted either to a sole manager or to a board of directors, as decided by the relevant shareholders' meeting. The SA will not be subject to the "independent" requirements as it could be in a SAPI and therefore it is common practice that the shareholders of an SA are the members of the board of directors. The SA must appoint a statutory examiner pursuant to the LGSM.

(ii) Minority Rights

Regarding minority rights exceptions according to the LGSM, SAPI shareholders that hold ten percent (10%)<sup>28</sup> of the shares representing its capital stock with voting rights (including limited or restricted) will have the right to:

- (1) appoint a member to the board of directors;

- (2) appoint an examiner (unless they elected to adopt the applicable regime of Public Companies); and
- (3) request the president of the board or an examiner to call a shareholders' meeting or to adjourn any shareholders' meeting in the event that they consider that they are not well informed with respect to a specific matter of the agenda.

Shareholders representing fifteen percent (15%) or more<sup>29</sup> of the shares representing the capital stock with voting rights (including limited or restricted) or without voting rights of a SAPI, may file a civil liability action in court against the directors or the examiners in the benefit of the corporation pursuant to the terms of the LGSM<sup>30</sup>.

Shareholders may judicially oppose to the shareholders' meetings' resolutions when they have a voting right in the corresponding matter, provided that, they individually or jointly hold twenty percent (20%) or

<sup>28</sup> In such cases, the 25% established by the LGSM, would not be applicable.

<sup>29</sup> In such case, the percentage established in the LGSM is 25%.

<sup>30</sup> The LGSM states that shareholders representing 25% of the capital stock, may file a civil liability action in court against the board members, only if the complaint comprises the total amount of liability against the company and not just those of the personal interest for the plaintiffs, as well as evidence that they did not vote in favour of not prosecute the board members, in the relevant shareholders' meeting.



more of the capital stock of the SAPI<sup>31</sup>.

(iii) Acquisition of its Own Shares

Another right (or exception) granted to SAPIs by the LMV is the possibility for these corporations to acquire its own shares<sup>32</sup>, with the prior agreement of their board of directors, in which case, such shares may be acquired by the SAPI itself either through its (i) net worth (*capital contable*), in which case such repurchased shares shall be kept by the SAPI without the need to reduce its capital stock or (ii) capital stock (*capital social*), as long as it is resolved to cancel them, or to convert them into issued and unsubscribed shares (*acciones emitidas no suscritas*) kept as “treasury shares”. The placement of a SAPI’s own shares will not require a resolution from the shareholders’ meeting, however, the board of directors shall adopt the relevant resolutions. The SAPI’s issued and unsubscribed shares kept as “treasury shares” may be subscribed by the same shareholders, in which case, the preemptive right established by the LGSM will not be applicable. Furthermore, SAPIs are not required to publish their financial

statements pursuant to the LGSM<sup>33</sup>.

III. Incorporation Process

The incorporation process of a Mexican corporation is quite unique and may not be compared with the incorporation process followed in common law countries. We can say that the incorporation process, once all of the required documents are properly prepared and delivered, may take from a couple of days up to five business days in order to have the business entity ready to start doing business in Mexico.

Due to our civil legal system, the participation of state appointed officers is required (with the same name but different functions as notary publics in common law countries), either *Notarios Públicos* (appointed by local governments) or *Corredores Públicos* (appointed by federal authorities) to carry out public certification of legal acts (“Public Faith Officers”). The participation of such Public Faith Officers in the incorporation process plays a very important role. They are professionals (in both cases, must be lawyers) that are granted “public faith authority” (*fe pública*) by the government with the function to certify legal acts. Generally, the participation of such Public Faith Officers is to formalize the consent of the shareholders or partners of the company and therefore, such shareholders or partners (or their representatives) must appear before

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<sup>31</sup> In such case, the 25% established by article 201 of the LGSM, will not be applicable.

<sup>32</sup> Again, this is an exception to the provisions of the LGSM, which states an express prohibition for an SA to acquire its own shares.

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<sup>33</sup> The LGSM states the obligation for an SA to publish their annual financial statements in the electronic system set forth by the SE as well as to deposit such financial statements before the RPC.





them to execute the relevant incorporation documents.

The process for incorporating a company in Mexico would need to follow the following steps:

1. To obtain from the Mexican Ministry of Economy (*Secretaría de Economía*) (“SE”) a permit to use the corporate name of the company (usually 1 business day);
2. To draft the by-laws of the company (based on the provisions of the LGSM or LMV and/or any shareholders agreement or other kind of agreement when different groups of shareholders or partners that shall be equity or stock holders of the company) (from 2 – 10 business days);
3. To execute the incorporation deed containing the company’s by-laws before a Public Faith Officer (including powers-of-attorney granted to officers of the relevant company) (usually 2 business days);
4. To file the public deed containing the articles of incorporation (and powers-of-attorney) of the company before the Mexican Public Commercial Registry (*Registro Público de Comercio*) (“RPC”) located in the company’s domicile (usually from 5 – 10 business days);
5. To file and obtain before the Mexican Tax authorities the tax identification number (RFC) which will allow the company to pay taxes, open bank accounts and electronically comply with its tax obligations. For such purposes, a domicile within Mexico is required in order to obtain the

relevant RFC of the Mexican company (from 1 – 5 business days); and

6. Filing and registration before other applicable Mexican authorities (such as the Foreign Investment Registry (*Registro Nacional de Inversión Extranjera*) (“RNIIE”). Thereafter and during the lifespan of the company, it will have to provide to such authorities, periodical information and/or renewal filings (from 5 – 7 business days).

The information required to incorporate either an SA or an SRL or a SAPI are practically the same. Please note as follows the information and/or documentation that would be required in order to incorporate either an SA, an SRL or a SAPI:

- (a) As mentioned above, before the incorporation of the company, it is required to obtain a permit from the SE for the use the corporate name. The SE requires the petitioner to provide up to three possible different corporate names for the new company, in case some of them are already used. It is utilized to secure the name and to avoid that two companies not related to each other share the same or similar corporate names;
- (b) The name of the persons who will be shareholders or partners of the company (at least two (2)<sup>34</sup>, which may be either individuals or entities). The shareholders or partners may grant a special power-of-attorney to the persons that will appear before the Public Faith

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<sup>34</sup> Except for the SAS.



Officer (*Notario* or *Corredor*) to incorporate the company on their behalf. Such power-of-attorney would also need to be valid and enforceable pursuant to Mexican law and therefore, if granted abroad, it shall be granted before a notary and comply with International Treaties signed by Mexico, such as the Inter-American Convention on the Legal Regime of Powers of Attorney to be used Abroad, the Washington Protocol on the Uniformity of Powers of Attorney and the Convention de La Haye. In order for such power-of-attorney to be effective in Mexico, it must also be translated into the Spanish language by an expert translator appointed by the relevant court;

- (c) The amount of the capital stock of the Mexican company and the participation of each shareholder or partner in such capital stock;
- (d) The name of each member of the board of directors or in the event that it is so decided, the name of the sole manager of the company, as well as the names of the examiner and main officers thereof;
- (e) The names of the persons that will receive powers-of-attorneys from the company, and the limitations to such powers-of-attorney (generally such persons would be carrying out the day to day management of such company); and
- (f) The rules regarding the dissolution and liquidation of the company.

Notwithstanding the foregoing, due to the issuance of a relatively new law called the

Mexican Federal Law for the Prevention and Identification of Transactions with Illegal Resources (*Ley Federal para la Prevención e Identificación de Operaciones con Recursos de Procedencia Ilícita*) (“Anti Money Laundry Law” or “AML Law”) there is the need to obtain additional information for the incorporation process such as:

1. Copies of the identifications documents of the individuals that will become partners or shareholders of the company or in the event of an entity it will be required a copy of the articles of incorporation and by-laws translated into Spanish (please note that this specific requirement may be time consuming);
2. Evidence or proof of the domicile mentioned for each shareholder, such as a copy of a utility bill (phone, electricity, etc.);
3. Tax identification numbers assigned by the relevant tax authorities of the country of origin of the individuals or entities that will become partners or shareholders of the company; and
4. General information of individuals or entities that will become partners or shareholders of the company, such as their telephone number and email address.

The AML Law has as main purpose to protect the financial system and the national economy from transactions carried out in Mexico with illegal resources. Therefore, it creates a new set of obligations for entities and/or individuals that carry out what the AML Law defines as “Vulnerable Activities”<sup>35</sup>.

<sup>35</sup> As listed in Article 17 of the AML Law.



Such “Vulnerable Activities” must be filed before the SAT through the elaboration of a report and that generally contains the description, among others, of (i) the transaction considered as “Vulnerable Activity”; (ii) the information of the parties involved in the “Vulnerable Activity” such as full name, address, incorporation information (in case of entities); and (iii) the amount of the transaction. Some of the “Vulnerable Activities” would be, among others and pursuant to the provisions set therein: (x) the lease of a real estate property; (y) the development of real estate; and (z) the incorporation process of a company, mergers, acquisitions, and capital increases.

**IV. Ongoing Maintenance**

The companies regulated under the LGSM and the SAPI pursuant to the LMV are required, among other matters, as its ongoing maintenance, to:

- (a) Execute a shareholders/partners meeting at the corporate domicile of the company at least once a year. In such meeting, the shareholders/partners shall approve the annual financial statement of the company, profits, ratify the board of directors and, in the case of the SA and the SAPI, ratify the report presented by the examiner.
- (b) Keep corporate ledgers whereby the names, nationalities, capital stock variations, shareholders’ or partners’ meetings, board of directors’ meetings and transfers of capital stock or equity be recorded. It is important to note that, according to the LGSM, the names of the shareholders/partners that

appear in such records are, with respect to third parties, the legal holders of the shares/equity participation that integrates the capital stock of the company.

- (c) Appoint a sole manager or, in its case, the members of the board of directors to fulfill the instructions provided by the shareholders/partners meetings and to direct the activities performed by the company.
- (d) In addition, pursuant to the AML Law, further requirements and reports will be necessary to be filed on a periodic basis to comply with such law.

**V. Taxation**

The SA, the SRL and the SAPI, once incorporated, shall obtain from the SAT a tax identification number (*RFC*) and will be considered as full Mexican entities for tax purposes, since such entity will be a Mexican resident with permanent establishment in the country. When the tax identification number (*RFC*) is obtained, the company may start issuing invoices for its business.

Residents of Mexico (individuals and corporations) are subject to taxation on their worldwide income, irrespective of the source of income or their nationality. Business entities having the principal administration of their business in Mexico are considered Mexican residents for tax purposes. We would recommend consulting a Mexican accountant or tax expert if specific and further information is required regarding tax matters.



## VI. Foreign Investment

The Mexican Foreign Investment Law (*Ley de Inversión Extranjera*) ("LIE") and its regulations regulate precisely foreign investments activities in Mexico. Such "foreign investment" could be done through:

- (a) the participation of foreigner investors, in any proportion, in the capital stock or equity of Mexican companies;
- (b) the activities performed by Mexican companies with majority of foreign capital stock or equity; and
- (c) the participation of foreign investors in the activities and actions contemplated by the LIE and its regulations.

There are a set of rules to be observed in connection with: (i) foreign ownership of real estate properties located in Mexico and; (ii) economic activities restricted to Mexican companies incorporated with foreign investment in Mexico.

- (1) Real Estate. A Mexican entity with foreign investment (foreign shareholders or partners) may acquire a real estate property in Mexico; however, it should be noted that, if such property is located within what is known as the "restricted zone" (*zona restringida*) which comprises an area of 100 kilometers (62.13 miles) across the Mexican border and 50 kilometers (31.06 miles) across the Mexican beaches and is acquired for residential purposes, then, such Mexican entity (as well as foreign individuals or foreign corporations) may not directly

acquire such property. Residential purposes shall be considered as those destined exclusively for living purposes of the owner or third parties. In such cases, a Mexican trust must be created where to the property is settled in trust and whereby such Mexican entity, foreign individual or foreign entity is appointed as beneficiary thereto (no real estate rights can be owned by such Mexican entity, foreign individual or foreign entity, only trust rights and the maximum duration of such trust is 50 years, subject to renewal); provided further that, in such cases it is required to obtain a permit from the Mexican Ministry of Foreign Affairs (*Secretaría de Relaciones Exteriores*) ("SRE") in order for such trust to own the relevant real estate property in the "restricted zone". As of today, there are discussions in the Mexican Congress in order to delete this Foreign Investment restriction on real estate.

On the other hand, a Mexican entity with foreign investment but which agrees to a statement called the "Calvo Clause" (which basically states that any foreign shareholder or partner shall be considered to be Mexican with respect to such participation or interest and shall agree not to invoke the protection of their Government, under the penalty, in case of failure to honor such commitment, to forfeit such interest or equity participation to the benefit of the Mexican Nation), may acquire property located in



the restricted zone for non-residential purposes, in which case, they would require to give a notice to the SRE of such acquisition within the next sixty (60) days following the date of the acquisition.

Non-residential purposes pursuant to the regulations of the LIE are considered as those destined to time sharing, industrial, commercial or tourism related activities and generally those used by entities pursuant to their corporate purpose, such as sales or transfers, urbanization, construction, or development of real estate projects.

Foreigners may acquire real estate properties outside of the “restricted zone” provided that they must obtain a permit from the SRE for such purposes.

- (2) Permitted Activities. According to the LIE there are three different types of reserved activities regulated by such law: (a) activities reserved to be performed exclusively by the Mexican State, which include, among others, petroleum, hydrocarbons and electricity (provided that private investment is allowed in such activities in accordance with the new Energy Reform which was recently passed on late 2013); (b) activities reserved to the Mexican State and to Mexican companies with “Foreigners Exclusion Clause”<sup>36</sup> provided in their by-laws, which

include, among others, national transportation of passengers in Mexican territory; and (c) activities with specific regulation where foreign investment can participate only in the percentages established by the LIE, such as national air transportation in which case a maximum twenty-five percent (25%) of foreign investment in the capital stock of the company is allowed or broadcasting companies in which case up to forty-nine percent (49%) of foreign investment in the capital stock of the company is allowed.

It is required the authorization of the National Foreign Investment Commission (*Comisión Nacional de Inversión Extranjera*) in order for Mexican companies with foreign investment to participate, directly or indirectly, in a proportion higher than forty-nine percent (49%) of its capital stock, in the event that such company performs the activities outlined in section (c) above.

Furthermore, and in order to control and regulate the provision set forth in the LIE and its regulations, the Mexican government through the SE created the RNIE in which, according to the LIE, the following entities are obliged to be registered:

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corporation shall not admit, directly or indirectly, foreign investors or corporations with foreigners' admission clause, as partners or stockholders.

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<sup>36</sup> An express agreement or covenant forming part of the company's corporate by-laws and setting forth that such





- i. Mexican companies in which foreign investment participates;
- ii. Foreign individuals or entities that normally perform commercial activities in Mexico; and
- iii. Stock or equity participation trusts of real estate or neutral investment, by virtue of which, rights in favor of foreigners are granted.

Mexican companies in which foreign investment participate in its capital stock are required to submit before the RNIE, quarterly and annually, reports which reflect the increase or decrease of participation of foreign investment in the capital stock of the companies and the fulfillment of the percentages established by the LIE, in the event that the company performs restricted economic activities.

## VII. Residency and Material Visa Restrictions

The Mexican government issued a series of amendments to the Mexican Immigration Law and its Regulations (the “MIL”), that caused great changes in the criteria applied by the Mexican National Immigration Institute (*Instituto Nacional de Migración*) which is the government entity in charge of issuing visas and observing the compliance of the MIL. The Mexican government issued such amendments with the main purpose of creating a more efficient system for foreigners visiting Mexico.

The MIL establishes, among others, the following visas that foreigners can request

from the Mexican National Immigration Institute in order to travel to Mexico:

- i. Tourist Visa: applicable for foreigners that travel to Mexico with the purpose of performing recreational, cultural, or sporting activities. Tourists are allowed by law to stay up to a term of 180 days in Mexico with the possibility of extending such term.
- ii. Permanent Resident or Temporary Resident Visa for Family Purposes: applicable for (i) Mexicans or foreigners that hold the condition of temporary students; or (ii) for permanent foreigner resident that requests a visa for a foreigner which he/she may prove a family bond.
- iii. Working Visa: applicable for foreigners, to whom an individual or an entity legally incorporated under Mexican law extends a job offer.

All of the abovementioned visas are issued for a limited period, but they are subject to renewals.

In general, the Mexican government carries out actions to promote tourism in the country, therefore, different from other countries, in Mexico there are no severe restrictions for foreigners to enter the country.

## VIII. Real Estate Trusts

In recent years, real estate trusts have also become important investment vehicles for foreigners who seek to invest their capital in Mexico. Trusts are regulated by, among others, the Mexican General Law for Negotiable Instruments and Credit Transactions (*Ley General de Títulos y Operaciones de Crédito*); (ii) the LMV; and (iii) the LISR.



The Mexican Congress, in order to make more attractive the investment of capital in the real estate market in Mexico, included in the LISR special tax benefits for Real Estate Investment Trusts (*Fideicomiso de Inversión en Bienes Raíces*) (“FIBRA”).

According to the Mexican Brokers-Dealers Association (*Asociación Mexicana de Intermediarios Bursátiles*), FIBRAs that have placed public offerings in the Mexican Stock Exchange have captured resources equivalent to thirty-seven-point three percent (37.3%) of the total foreign investment in Mexico.

According to the LISR, in order for a trust to be considered a FIBRA and to have the tax benefits provided by the LISR, it needs to comply, among others, with the following requirements:

- i. to be executed pursuant to Mexican laws and with a Mexican trustee.
- ii. to have as its main purpose the acquisition or construction of real estates in Mexico that may be destined for lease, or the right to obtain income from the real estate.
- iii. that the real estate contracted or acquired by the FIBRA be destined to lease (or equivalent) and not be sold within a period of 4 years following the date the construction of the real estate was completed or as of the date of the acquisition of the real estate, as applicable.
- iv. that the trustee of the FIBRA issues trust certificates to represent the assets allocated in the FIBRA so that such certificates may be placed through a public offering in the Mexican Stock Exchange and registered before the RNV; and
- v. that the trustee of the FIBRA distributes to the holders of the relevant trust certificates issued through the public offer, at least once a year and no later than March 15th of each year, at least ninety-five percent (95%) of the total taxable income accrued during the immediately preceding fiscal year.

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# INTERNATIONAL LAWYERS NETWORK



PLASBOSSINADE ADVOCATEN EN NOTARISSEN  
ESTABLISHING A BUSINESS ENTITY IN THE  
NETHERLANDS

## ESTABLISHING A BUSINESS ENTITY IN THE NETHERLANDS

### INTRODUCTION

PlasBossinade Advocaten en Notarissen is a Dutch full-service law firm at which lawyers, civil law notaries and tax lawyers practice the law in all of the commercial areas. This contribution is a brief summary of the subject and our specialists on request are ready to give more information trimmed for the purpose.

### TYPES OF BUSINESS ENTITIES

In the Netherlands, we distinguish legal entities which are by law acknowledged to be legal persons (“rechtspersonen”) and entities which do not have the status of a legal person. The latter category may be regarded as types of co-operation between entrepreneurs, which co-operations will mainly be transparent for tax purposes. Income tax will be levied at the level of the partners of the co-operation entity, not at the level of the entity itself. For more information about some items of Dutch tax law in relation to enterprises, see hereafter under Tax Issues. Legal persons are subjects of law and as such carriers of rights and obligations like individual persons are. The rights and obligations of non-legal persons in principle are carried by the persons or legal persons for whose account the non-legal entity is carrying on its business activities.

*For example: A Dutch person and a German company form a Dutch resident partnership in marketing and selling electronic equipment. According to Dutch law the partnership is not a legal person. The Dutch person and the German company in principle are each fully liable towards third parties for the obligations of the partnership. Should the partners incorporate a Dutch company, the latter will be a legal person and exclusively liable. The partners, as shareholders and/or managing*

*directors will not be liable, unless they bind themselves pursuant to a surety or in the event that they may have acted negligently.*

### Legal persons

The most common type of legal persons in the Netherlands is the limited liability company (“**besloten vennootschap met beperkte aansprakelijkheid**”, or “B.V.”). The other type of legal persons is the public company (“**naamloze vennootschap**”, or “N.V.”). The Societas Europea (S.E.) is the European equivalent of the N.V. and may also be incorporated in the Netherlands, provided that the company will operate under the laws of at least two EU member states and will be governed by the SE-Directive.

The B.V. is as a type of company comparable with the N.V., from which it stems since 1975. In 2012 the law on B.V.’s was fundamentally changed. The most characteristic differences between the N.V. and the B.V. were always the fact that shares in an N.V. may be freely traded (on a stock exchange or otherwise) whereas the transfer of shares in a B.V. was blocked by either pre-emption rights of the other shareholders or a right of approval by the management of the company or another body within the company. Also, the minimum capital requirements (EUR 45.000, -- for the N.V. and EUR 18.000, -- for the B.V.) were relevant distinctions between the two types of companies. As per October 2012, a change in the law turned the B.V. into a far more flexible type of company by way of striking the minimum capital requirements, making it possible to transfer shares freely and liberating the possibilities to contribute on shares and to distribute dividends.

Since October 2012 it is very easy to establish a B.V. in the Netherlands and to trim it to the

specific needs one has. The popularity of the B.V. as most used corporate type in the Netherlands is not to be beaten. Some of the most important elements concerning the B.V. are the following (this applies in principle to the N.V. as well, unless stated otherwise):

#### Name

The incorporator is free in choosing a name, provided that in doing so it will not violate an existing trade name or trade mark of third parties. The name of the company is also the trade name under which the B.V. operates, with the letters “B.V.” added thereto. The B.V. may use more trade names, and may file these at the Dutch trade registry, but the addition “B.V.” is reserved for the formal, statutory name.

#### Seat

The B.V. has its statutory seat in the Netherlands and needs to have an address in the Netherlands. It may operate abroad.

#### Share capital

The share capital of the B.V. needs to be minimal EUR 0,01 (N.V.: minimal EUR 45,000; SE minimal EUR 120,000).

#### Types of shares

Ordinary shares do have voting rights and dividend rights. It is possible to create non-voting shares (not in the N.V.), which then still do have dividend rights. Other types of shares are (i) preferred shares, which do have a preference over the profits, for instance a fixed percentage of the par value of the preferred shares and a right to receive the profits in later years with respect to earlier years in which no profits were made (cumulative preferred shares); and (ii) priority shares, which may entitle the holder to a right of approval in respect of certain

management board and/or shareholder resolutions.

The articles of association of a B.V. may impose certain obligations on the holders of shares which go further than paying up the issued shares, for instance the obligation to enter into a joint venture agreement with the B.V. Acting in contravention with such additional obligations may trigger a suspension of the voting rights attached to the shares or the obligation to offer the shares to third parties.

The transfer of shares requires a notarial deed of transfer, unless shares are listed at a stock exchange. The articles of association may contain a blocking clause which provides for pre-emptive rights for existing shareholders or a right of prior approval for the transfer by a certain body of the company.

#### Shareholders meeting

The shareholders meeting is the highest body within the organisation of a B.V. or N.V. and in principle decides on all issues which do not belong to the competence of other bodies. Issues which are to be resolved by the shareholders meeting are, amongst others, establishing the annual accounts, amending the articles of association, appointment, and dismissal of managing directors and supervisory directors, winding up, etc.

#### Management Board

The management board consists of one or more managing directors. Their appointment and remuneration in principle is being decided by the shareholders meeting. There are no restrictions on nationality or place of residence of managing directors. Legal entities may also be appointed as managing director. There is no need to have a natural person appointed.



The company may be represented by each managing director, the management board jointly or two or more managing directors jointly, depending on the system elected. The power to represent is unlimited. If one would like to limit such powers one should elect the system that the company can only be represented by two managing directors jointly or by the full management board, with a power of attorney to one or more managing directors specifically prescribing their authority. In acting they will then act as proxy, not as managing director.

#### Supervisory Board

A supervisory board is optional, unless the company may be regarded as a “large company” (see hereafter).

The supervisory board will be appointed and dismissed by the shareholders meeting, and may consist of one or more members. The task of the supervisory board is to supervise the functioning of the managing director(s) and to advise the same.

Large companies are companies with an equity (issued and paid up share capital plus reserves) of EUR 16 million, a works council and at least 100 employees working in the Netherlands. Large companies are obliged to have a supervisory board of at least three members and some powers which in the normal B.V. or N.V. are the exclusive domain of the shareholders meeting become powers of the supervisory board, such as the appointment and dismissal of managing directors and the approval of certain board resolutions with large impact, such as doing mergers or acquisitions of a certain scale, amendment of the articles of association, winding up etc.

Since 2012 the B.V. may be organized with a one tier board, consisting of one or more

executive and one or more non-executive directors, headed by a non-executive director.

#### Shareholders resolutions

Shareholders resolutions in principle are to be taken by simple majority, based on the nominal value of the shares, unless the articles of association provide for a special majority and/or quorum. In respect of the dismissal of managing directors the law provides that the requested majority may not be more than two-thirds of the votes representing a maximum of half of the issued share capital. Should the articles of association contain higher levels of majority or quorum on this issue, such provision will be null and void.

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Other types of legal persons which are being used commercially are the cooperation (“**coöperatie**”) and the mutual society (“**Onderlinge waarborgmaatschappij**”) which are both species of the “vereniging”, which is a kind of association or union. The coöperatie originally was a form of organization of farmers, being the members, who traded their produce with a central producing unit owned by the coöperatie, which producing unit (a milk or cheese factory, for instance) sold the end product to the market, on behalf of the coöperatie. The members receive a price for their produce and on top of that they share in the profit of the coöperatie. Members may be fully liable, limited liable or not liable at all towards third parties, depending on the structure which is being implemented and as such registered with the trade registry. Although still in use in agricultural settings, nowadays the coöperatie is also being chosen by organisations of professionals, such as lawyers or accountants, for reason of the

possibility to limit liability and to steer clear from certain tax implications. The *onderlinge waarborgmaatschappij* is in fact a *coöperatie* which undertakes insurance activities primarily for its members. It may perform such activities also for third parties, provided that the activities performed for the members form the greater part.

The last legal entity which one may encounter in the Netherlands in relation to corporate structures is the foundation (“*stichting*”). A foundation is an entity in itself, governed by a board which, depending on the organisational statute, may be supervised by another body. Typical of the foundation is that it does not issue shares nor membership rights and that the equity of the foundation will be solely available to further the statutory objects of the foundation, which objects may not consist of making distributions to its incorporators or to third parties, unless (as to the latter category) the distributions will have an ideal or social purpose. Foundations most commonly are used in the field of cultural, social, and healthcare institutions, but may also serve as vehicle for undertaking commercial activities. Given the restrictions on making distributions such commercial activities mostly are in function of the ideal objects. Another purpose for foundations is to serve as an instrument for separating the dividend rights attached to shares from the voting rights. This is called “certification of shares”. A foundation can be used for the purpose of holding shares in an N.V. or B.V. whereby the voting rights attached to the shares will be exercised by the board of the foundation whereas the dividend rights attached to the same shares will accrue to certificates to be issued to third parties. In doing so the holders of the certificates in fact will own shares without voting rights. This practice is generally used in the Netherlands, mainly in structuring ownership of family

businesses. One or more family members who are involved in the business will then hold ordinary shares and the board position(s) in the foundation, whereas the other family members will only hold certificates with dividend rights. Since the creation of shares without voting rights in the B.V., in 2012, other solutions are available to trim the right structure. Certification of shares is also used as a shield for N.V.’s listed on the Dutch stock exchanges. A sizeable part of the shares may be held by the foundation and brought to the market in the form of certificates, whereby voting rights attached to the shares will be exercised by a board which aims to protect the interests of the company against raiders and the certificates are entitled only to the dividends.

### **Non-legal entities**

The non-legal entities which are available in the Netherlands are listed hereunder. These entities in principle are transparent for (corporate) income tax purposes, meaning that this tax is levied at the level of the partners, not at the level of the entity itself:

Sole proprietorship (“*eenmanszaak*”): strictly speaking this is no form of organisation. An individual which is taking up a business and who acts in the course of that business without choosing some sort of company form or co-operation with other entrepreneurs, is acting as a sole proprietor. Rights and obligations of the business are by operation of law rights and obligations of the individual. Please note that such an entrepreneur may also employ people working in the business. Those employees are employed by the entrepreneur himself and may claim their wages from him personally and may execute his private belongings in pursuing their claim.

Partnership (“*maatschap*” or “*vennootschap onder firma*”): in the Netherlands, there are

two types of partnerships, being the *maatschap* intended for co-operating professionals, such as lawyers, dentists, doctors, architects and accountants, and the *vennootschap onder firma* intended for any other business type. Characteristic for both types is that the partners have contributed monies or goods and provide their labour and skills to the partnership. The main distinction between the *maatschap* and the *vennootschap onder firma* is that partners in the *maatschap* will be liable towards third parties in proportion to their number (with 3 partners every partner will be liable for 1/3), whereas partners in the *vennootschap onder firma* will be liable jointly and severally each for the full amount of the liability.

Limited Partnership (“*commanditaire vennootschap*” or “*C.V.*”): the limited partnership is in fact a sole proprietorship or partnership with one or more “silent” partners added. The silent partners contribute money or goods to the C.V. but are not visible for the public and they may not perform any acts on behalf of the C.V. They may, however, participate in decision making at the level of the partners meeting. The silent partners are not filed at the trade registry (only the number of silent partners and the amount of the capital they paid in has to be filed). The business is conducted on behalf of C.V., so the revenues are to be split between all partners in a way to be determined by the deed of partnership. Losses will be borne by the C.V. as such, but silent partners will not be liable to provide extra capital in such circumstances nor will they be liable towards third parties who may have a claim on the C.V. Such liability towards third parties will be triggered as a kind of penalty in case a silent partner did perform an act on behalf of the C.V. Whether this will be a liability for any and all existing liabilities

of the C.V. and whether the liability will only be towards the party with whom the silent partner acted, or will be a liability towards the generality of creditors of the C.V. is undecided. Given the available case law on the subject it is safe to assume that the penalty will be full liability towards all creditors.

## STEPS AND TIMING TO ESTABLISH

### Legal persons

Legal persons will be incorporated by a notarial deed to be passed by a civil law notary in the Netherlands. The notarial deed contains the Articles of Association, which provide for name, corporate objects, number and type of shares, authorized and paid in capital, number and authority of the managing directors, whether a supervisory board will be formed and any and all other regulations concerning the governance and operation of the entity.

Apart from the incorporation of a *coöperatie* or *onderlinge waarbormaatschappij*, being a special type of society and as such assuming at least two members, all legal entities may be incorporated by one single incorporator.

It should be noted that the effect of bringing rights and obligations within the shell of a legal entity will only be realised upon incorporation of the legal entity and filing the entity in the trade registry in the Netherlands. Acts performed on behalf of the entity in the stage prior to incorporation and/or registration will only become acts of the entity once such acts will be ratified by the management board after the registration has taken place. If such ratification does not take place, or is done prior to registration, the persons acting on behalf of the entity are and remain personally liable towards third parties. For the N.V. and the B.V. the law provides that such ratification, if done by the management board whilst the board

knows or reasonably should know that the N.V. or B.V. will not be able to meet the obligations resulting from the acts ratified, the personal liability of the persons who acted will revive and the board members who ratified the acts may also be held personally liable.

The steps to be taken in the course of incorporating a legal entity are the following:

1. A civil law notary will have to be instructed to make a draft deed of incorporation;
2. Once the deed is in conformity with the requirements of the incorporator, incorporation can take place immediately. Incorporators do not have to attend the incorporation in person. They may be represented by local residents, provided that their identity is confirmed through an apostilled legalization. Persons incorporating a company in the Netherlands, as well as (foreign) companies acting as such will be screened pursuant to the Anti-Money Laundering and Counter-Terrorist Act (WWFT);
3. In the deed of incorporation, the initial management board member(s) and (if applicable) the first supervisory board member(s) will be appointed;
4. If an N.V. or B.V. is incorporated the share capital needs to be paid in forthwith upon incorporation;
5. For the N.V. and B.V. contribution in kind is possible but in principle requires a description of the goods (an existing enterprise, other assets and liabilities etc.) and a valuation. For the N.V. an additional requirement for the contribution in kind is a statement of a certified public accountant which confirms that the value of the contribution at least equals the amount of the payment obligation on the shares issued. These rules also apply to the acquisition by the N.V. in the period from incorporation until two years thereafter of goods which did belong to incorporators or shareholders (“Nachgründung”).
6. The notary will file the entity at the trade registry, in principle on the same day as the incorporation, and an extract showing the entry can be obtained immediately.

The time-frame will for the greater part be influenced by the time involved in providing the notary the proper instructions and documentation. Incorporation and registration itself do not take more than one day in the Netherlands.

### **Non-legal entities**

Non-legal entities are being established pursuant to a private agreement concluded between the parties becoming a partner to the entity. There are no formal requirements to be met, other than that these entities will have to be filed at the trade registry upon their establishment. The name and address of each partner will be recorded, as well as the address of the entity itself, which should be an address in the Netherlands. Silent partners of a C.V. will not be recorded; only the amount of the paid in capital and the number of the silent partners need to be filed.

## **GOVERNANCE AND ONGOING MAINTENANCE**

### **Legal Persons**

#### *Governance*

With respect to governance issues we refer to what is being written on the specifics of the N.V. and the B.V. above.

#### *Maintenance*

In this summary, we confine ourselves to the most common entities for commercial use, being the N.V. and the B.V. Pursuant to the Dutch Civil Code, the management needs to keep account of the rights and obligations of these companies on an ongoing basis, in order that at any given moment the financial status may be known. Books and documents need to be stored for at least 7 years. Furthermore,

each year within 5 months from the financial year end (or 10 months if prolonged by the general meeting of shareholders), the management needs to draft the annual accounts and to present these to the general meeting of shareholders. The shareholders have to establish the annual accounts within two months upon the end of the 5 or 10 months' term. Within 8 days from establishment the annual accounts need to be filed at the trade registry.

If the company at least fulfils two of the three following criteria, it will be required to have the annual accounts audited by a certified public accountant: (1) turnover of more than EUR 8,800,000; (2) balance sheet total of more than EUR 4,400,000; (3) average number of full-time employees of 50 or more.

Non-compliance with these financial rules may give rise to criminal fines for the management. In the event that the company goes into bankruptcy and the non-compliance has taken place in the three years prior to the bankruptcy, it is a legal fact that the management acted improperly and by operation of law it is assumed that the improper performance of the management tasks is a material cause for the bankruptcy. This may lead to personal liability of all board members for the total deficit in a bankruptcy of the company.

Companies need to file timely tax returns concerning all taxes, such as for instance wage tax, value added tax (VAT), corporate income tax and dividend tax.

### **Non-legal entities**

#### *Governance*

With respect to governance issues we refer to what is being written on the specifics of the non-legal entities above.

#### *Maintenance*

Pursuant to Dutch tax law, non-legal entities do have an obligation to keep account of their rights and obligations in a proper manner and to keep the books and documents for at least 7 years. There is no obligation to publish annual accounts, since the activities of the non-legal entity in principle are being conducted for the account of the participants. In the event that participants do have the company form (N.V. or B.V.) such companies do have to publish their accounts in accordance with what has been stated above.

Non-legal entities need to file timely tax returns concerning all taxes, such as for instance wage tax, value added tax (VAT) and income tax.

### **TAX ISSUES: PARTICIPATION EXEMPTION/THIN CAPITALISATION/WITHHOLDING TAX**

#### **Participation Exemption**

A legal person established in the Netherlands is subject to Dutch taxes. The foreign company investing in a legal person in the Netherlands will therefore also be confronted with Dutch tax law. In case transactions between affiliated companies take place, such as financing, delivery of goods or services, parties should trade at arm's length to meet the requirements of the tax authorities of the countries involved (transfer pricing).

When cross border activities are performed, not only Dutch tax law may be relevant. The Netherlands have negotiated tax treaties with many countries. Furthermore, EU law and regulations may apply, such as the Parents-Subsidiary Directive which provides for tax exemption for cross-border dividends paid between related companies located in different EU member states. Another example is the Mergers Directive, which facilitates cross-border mergers, divisions, transfers of assets or exchanges of shares in the EU.



A company which holds more than 5% of the shares in a N.V. or B.V. – which N.V. or B.V. is not an investment company – can apply the participation exemption for corporate income tax purposes. The profit of a Dutch subsidiary is principally only taxed once with corporate income tax. Dividends paid to the parent company are in principle not taxable, so no double taxation arises.

### **Thin Capitalisation**

Due to erosion of the tax base profit in the Netherlands, the corporate income tax act holds a number of provisions with regard to the limitation of deductibility of interest payments to affiliates or third parties, instead of the (abolished) thin capitalization rules. For example, excessive interest cost of a parent company with regard to a subsidiary are limited deductible for corporate income tax. Financing schemes within a group of (international) affiliated companies may be confronted with limited deductibility of interest, for different situations.

### **Withholding tax**

Interest and royalty payments from a legal person in the Netherlands to foreign companies are not subject to Dutch withholding tax.

Dividends may be subject to Dutch dividend withholding tax. The Dutch withholding tax rate for dividend is 15%. In case the participation exemption of the corporate income tax act is applicable no dividend withholding tax is due. A lower tax rate than 15% can be applicable in case the participation exemption does not apply and The Netherlands and the country of the receiving parent company do have a tax treaty.

## **RESIDENCY AND MATERIAL VISA RESTRICTIONS**

### **Work permit/duty to inform**

The employer in principle must apply for a work permit or a single permit in the event that he wishes to have a Non-EU citizen (hereinafter: “the alien”) perform work in the Netherlands. An exception is made for employers who are established outside of the Netherlands and who wish to have an alien perform work that is of a temporary nature. Companies (hereinafter “the service provider”) who have an assignment agreement with a client established in the Netherlands and who on that basis have their employees from third countries perform work in the Netherlands, are not required to apply for a work permit (which also includes the secondment of an employee), provided that the conditions enumerated hereafter are met:

- it must concern an alien who is entitled to reside in the country of establishment of the service provider and who is allowed to perform the relevant work there;
- the alien must be employed with an employer who is established outside of the Netherlands, which means that the enterprise has its seat outside of the Netherlands and carries out effective and genuine economic activities that are not purely marginal and ancillary;
- the employer intends to temporarily provide services in the Netherlands (which implies that it performs economic activities for an economic consideration, other than paid employment);
- the enterprise is not established in the Netherlands; should the enterprise be established in the Netherlands, and in another member state of the European Union as well, the exemption scheme applies in the event that the alien is temporarily performing work in the Netherlands from the foreign

branch within the scope of cross-border services.

Before the temporary provision of services by an alien in the Netherlands commences, the employer must inform the UWV (Employee Insurance Agency) thereof in writing and it must submit a statement and documents of proof (the duty to inform). This duty to inform applies each time the employee involved travels to the Netherlands.

The employer must submit documents of proof showing that the alien is entitled to reside in the country of establishment of the employer and that he has been granted permission to perform work there.

Moreover, a fully filled out E101 Declaration that is valid for the relevant work must be submitted, stating that the employee will carry out the activities in the Netherlands, or a truthful and written declaration made by the employer, drawn up in a form issued by UWV for that purpose, mentioning the name and the address of the employer, an indication of the nature of his enterprise and the registration data in the country of establishment, the name and address of the person on whose behalf the services are rendered, the nature of these services, where and when the alien will carry out his activities and the identity data of the alien.

### **Residence permit**

In the event of a maximum stay of 90 days in the Netherlands, the employee requires a type C visa. Should the employee involved remain in the Netherlands for a period longer than 90 days, he is obligated to apply for a residence permit for cross-border services. The employee does not require a provisional residence permit to travel to the Netherlands.

The temporary provision of services cannot last any longer than two years. After that period, the alien must return to the country of his employer.

### **Occasional work**

A work permit is not required in the event that the alien has his main residence outside of the Netherlands and performs occasional work that exists of installing or repairing tools or machinery or installing and modifying software supplied by the employer or giving instructions as to the use thereof. Conducting business meetings or entering into agreements with companies and institutions also falls under the scope of 'occasional work'.

The occasional work may last for a maximum period of twelve consecutive weeks, within a time frame of 36 weeks.



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# INTERNATIONAL LAWYERS NETWORK



**BURTON PARTNERS  
ESTABLISHING A BUSINESS ENTITY IN NEW  
ZEALAND**



## ESTABLISHING A BUSINESS ENTITY IN NEW ZEALAND

### TYPES OF BUSINESS ENTITIES

There are various entities available in New Zealand from which a business can be operated. The most commonly adopted entities are:

1. Company (including Incorporated Joint Venture (JVC))
2. Partnership
3. Limited Partnership (LP)
4. Unincorporated Joint Venture (JV)
5. Trading Trust

Each has its advantages and disadvantages, and each pose different obligations and requirements, both from a regulatory perspective and an internal perspective.

The following summarises the general characteristics, obligations, and requirements of each.

#### COMPANY

A company is the most common form of business entity adopted in New Zealand. A company has separate legal identity and provides limited liability protection for its shareholders.

Companies in New Zealand are governed by the Companies Act 1993 ('Companies Act'), and the company's constitution (if adopted). It is optional for a company to adopt a constitution. Where there are numerous shareholders, it is also common for a shareholder's agreement to be implemented.

The Companies Act applies to all companies. It contains mandatory, default and optional provisions. Mandatory provisions cannot be contracted out of, and include provisions relating to minority protection, major transactions, and directors' duties. Default

provisions however can be contracted out through the company's constitution, and apply by default where the company has not adopted a constitution or are not otherwise dealt with in the constitution.

The regulatory body is the Companies Office. The process to incorporate a company is completed online through the Companies Office website. The basic requirements for incorporation of a company are:

1. The company must have at least 1 director and at least 1 shareholder, and at least 1 director must either be a NZ resident or a director of an Australian company who is living in Australia;
2. A registered office and address for service in New Zealand;
3. A minimum of 1 share. There are no capitalisation or minimum share value requirements; and
4. Registration with the Companies Office.

The online process for registration with the Companies Office is relatively fast and simple. The process is effectively two-part. The process and information required to be disclosed is simplified as follows:

1. Step 1 – Reserve the company name. This is completed online through the Companies Office website.
2. Step 2 – Submit application for incorporation, which includes:
  - (a) Providing addresses and shareholder and director information





- (b) Providing consent forms signed by each shareholder and director
- (c) Pay the minimal registration fee

You can choose to register the company for tax at the time of incorporation and basic tax

elections made. If so, New Zealand IRD numbers need to be provided for each New Zealand resident director and shareholder. IRD and tax matters are discussed in more detail below.

Notable advantages and disadvantages of companies are as follows:

Advantages	Disadvantages
<p>Separate legal identity</p> <ul style="list-style-type: none"> <li>• Company itself can hold assets and incur obligations and liabilities</li> </ul> <p>Limited liability</p> <ul style="list-style-type: none"> <li>• Shareholders liable only to the value of their investment; no liability for directors (except when breach of duties)</li> </ul> <p>Perpetual succession</p> <ul style="list-style-type: none"> <li>• Continues to exist unless removed from the Companies Office register (despite changes in control/ownership/management)</li> </ul> <p>A constitution and/or shareholders agreement can be implemented to cater to the specifics of the company (except to vary mandatory provisions in the Companies Act)</p> <p>Suited to passive investors, reasons include:</p> <ul style="list-style-type: none"> <li>• Board handles management and day to day operations</li> <li>• Board has strict duties to company/shareholders – both under the Companies Act and under common law – must act in the best interests of the company; avoid conflict of interest; disclose personal</li> </ul>	<p>Ongoing statutory administrative obligations, including:</p> <ul style="list-style-type: none"> <li>• Filing annual returns – failing which, the company will be removed from the Companies Office register</li> <li>• Maintaining a share register</li> <li>• Keeping minutes of meetings</li> <li>• In some cases, preparing and/or auditing financial statements; financial reporting obligations</li> </ul> <p>Mandatory provisions in the Companies Act cannot be contracted out of, by a constitution or otherwise</p> <p>From the board’s perspective – whilst the company has limited liability, directors can be held personally liable when there is a breach of duties</p> <p>Certain details must be registered with the Companies Office, and are thus publicly available and viewable, including:</p> <ul style="list-style-type: none"> <li>• Company’s name</li> <li>• Directors – name and address</li> <li>• Shareholders – name and address</li> <li>• Company’s registered office and address for service</li> </ul>





<p>interests</p> <ul style="list-style-type: none"> <li>• Under the Companies Act shareholders maintain certain powers – including appointment/removal of directors and the approval of “major transactions” which require a 75% shareholder resolution</li> <li>• The Companies Act provides some limited protection for minority shareholders, including “minority buy-out rights” in certain circumstances</li> </ul> <p>Flexibility to introduce/raise new capital The Board may delegate responsibilities</p> <p><b>Tax:</b> Company income is taxed at a flat rate of 28% Losses can be carried forward (subject to 49% shareholder continuity) Imputation credits can be applied to shareholder dividends (however limits apply)</p>	<ul style="list-style-type: none"> <li>• Constitution</li> </ul> <p>Dividends/distributions can only be paid if the company meets the solvency test. The solvency test essentially requires that the company can pay its debts as they fall due and has assets that exceed its liabilities</p> <p><b>Tax:</b> Dividends are subject to a RWT taxed at a flat rate of 33%</p>
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**Overseas companies**

An overseas company is defined in the Companies Act as “a body corporate incorporated outside NZ”.

If you already operate an overseas company (with exceptions for Australian companies), that overseas company can then operate in New Zealand in any one of the following three ways:

1. Setting up a subsidiary (i.e. incorporating a company in New Zealand, with the shareholding held entirely by the parent company); or

2. Becoming a New Zealand company (i.e. transferring incorporation to New Zealand); or
3. Registering a branch in New Zealand.

The process for registering a branch in New Zealand is a two-part online process, completed through the Companies Office website, and again is relatively fast and simple. The process is as follows:

1. Step 1 - Reserve the overseas company’s name – only then can the overseas company commence carrying on business in New Zealand; and



2. Step 2 – Apply for registration within 10 working days of commencing business in New Zealand.

### Financial reporting obligations

There are specific financial reporting obligations for certain companies. This includes companies deemed to be “large” public companies, large overseas companies, and companies with 10 or more shareholders. Those reporting obligations are statutory obligations, however would, for the most part, foreseeably be complied with in any event in the ordinary course of business.

Generally, a company is deemed “large” if at the balance date of the past two accounting periods:

1. In the case of a New Zealand company:
  - (a) Assets of entity and subsidiaries > \$60m OR
  - (b) Revenue of entity and subsidiaries > \$30m
2. In the case of an overseas company (with exceptions for Australian companies):
  - (a) Assets of entity and subsidiaries > \$20m OR
  - (b) Revenue of entity and subsidiaries > \$10m

### NZX Listing

New Zealand’s securities markets are operated by NZX. There are three securities markets:

1. New Zealand Stock Market (NZSX)
2. New Zealand Debt Market (NZDX)
3. New Zealand Alternative Market (NZAX)

If you are interested in listing a company in New Zealand, you must apply for listing

through the NZX and comply with the NZX listing rules. The same requirements apply to overseas companies as apply to New Zealand companies, and NZX recognises dual listing.

### Takeovers

The Takeovers Act 1993 (‘Takeovers Act’) and its regulations apply to a “code company” (i.e. either a New Zealand listed company or a New Zealand company with 50 or more shareholders and 50 or more share parcels). The Takeovers Act provides minimum standards which must be complied with if you are attempting to acquire shares in a code company. The Takeovers Act established the “Takeovers Code” and implemented the “Takeovers Panel” which sits in deliberation on takeover offers.

Generally, the Takeovers Code must be complied if you attempt to acquire (or increase to) more than 20% voting rights in a code company.

### PARTNERSHIP

A partnership is deemed to exist when two or more ‘partners’ carry on business in common with a view to profit. Generally, a partnership agreement is drawn up to reflect the terms of the partnership. A partnership agreement is however optional, and in the absence of a partnership agreement, the provisions of the Partnership Act 1908 apply by default.

There are no formal registration requirements in New Zealand. There are also little statutory obligations and requirements, and for the most part, partners have the flexibility and freedom to structure and operate their partnership as they wish.

Often the obvious disadvantages of partnerships are the absence of a separate legal identity and limited liability protection. Partnerships are therefore becoming less



common now as the ‘hybrid’ limited partnership option (discussed below) provides similar benefits without these two main disadvantages.

Notable advantages and disadvantages of partnerships are as follows:

Advantages	Disadvantages
<p>Flexibility and freedom in drafting partnership agreement</p> <p>No registration requirements</p> <p>No statutory ongoing administrative obligations</p> <p>The partnership agreement and other information relating to partnership structure and operations can remain confidential</p> <p>The partners’ capital contributions can be in any form – including cash, loans, skills, or assets</p> <p>Subject to the partnership agreement, there is flexibility as to distribution of profits/income; specifically, there is no solvency test requirements</p> <p>From each individual partners' perspective, all partners owe fiduciary obligations to each other</p>	<p>The partnership does not have a separate legal identity from the partners</p> <p>No limited liability protection – partners can be personally sued and held liable (however subject to the partnership agreement, partners can be indemnified by the partnership)</p> <p>Subject to the partnership agreement:</p> <ul style="list-style-type: none"> <li>• Any partner can bind all other partners – partners have unlimited joint and several liability</li> <li>• Partners are beneficial and equal co-owners of all the partnerships’ property and assets, regardless of contributions</li> <li>• Partners are entitled to equal share in profits, regardless of contributions</li> <li>• There are often difficulties in raising additional capital as unanimous consent is required to introduce a new partner</li> <li>• Not suited to passive investors – subject to partnership agreement, all partners participate in management and day to day operations</li> <li>• The partnership is technically dissolved each time a partner retires, replaced and/or a new partner is introduced</li> </ul>
<p><b>Tax:</b></p> <p>Partnerships are fiscally transparent for tax purposes – the partnership is not a</p>	<p><b>Tax:</b></p> <p>As a partnership, not a separate legal entity, partners are jointly and severally liable for</p>



<p>separate legal entity, so each partner’s income share is taxed according to its own tax status</p> <p>Tax losses can be passed through, utilised or carried forward</p> <p>No RWT/NRWT payable</p> <p>Loss limitation rule does not apply</p> <p>The partnership can register for GST</p>	<p>GST obligations</p>
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**LIMITED PARTNERSHIP (LP)**

Limited partnerships (LP) were only recently introduced into New Zealand. They are governed by the Limited Partnership Act 2008 (‘Limited Partnerships Act’) and are regulated by the Companies Office.

Whilst only recently introduced into New Zealand, LPs have existed in other jurisdictions for some time. The LP model in New Zealand is much the same as that in other jurisdictions. In essence, they are a ‘hybrid’ of a company and partnership, integrating the limited liability and separate legal identity benefits of a company, and some of the flexibility and the look-through tax benefits of a partnership.

In place of a director, is a ‘general partner’. They are responsible for the management and day to day operations of the LP, effectively taking on the role of the agent for the LP. Generally, a corporate entity is appointed as a general partner. In place of shareholders, are ‘limited partners’ whose identity is not publicly available. They contribute capital to the LP and their liability is limited only to the extent of such contributions. Under the Limited Partners Act, limited partners are generally prohibited from being involved in the management and day to day operations of the LP outside

specified ‘safe harbours’. Limited partners that take part in management risk losing their limited liability protection.

The Limited Partnerships Act requires that a LP have a limited partnership agreement, and sets out the minimal provisions that must be provided for therein. The LP has the freedom and flexibility to include other provisions as appropriate to cater to the specifics of the LP.

LPs are incorporated entities. The process to register a LP is completed by submitting a written application to the Companies Office. The requirements for registration are:

1. Limited partnership agreement;
2. At least 1 general partner and at least 1 limited partner, and at least 1 general partner must:
  - (a) If a natural person, either be a New Zealand resident, or a director of an Australian company who is living in Australia; or
  - (b) If an entity, either be a New Zealand company or partnership, or an overseas company with a director who is either a New Zealand resident or a director of an Australian company who is living in Australia



3. A registered office and address for service in New Zealand;
4. Registration with the Companies Office.

Notable advantages and disadvantages of LPs are as follows:

Advantages	Disadvantages
<p>Separate legal identity</p> <ul style="list-style-type: none"> <li>• LP itself can hold assets and incur obligations and liabilities</li> </ul> <p>Limited liability</p> <ul style="list-style-type: none"> <li>• Limited partners liable only to the value of their investment</li> </ul> <p>Perpetual succession</p> <ul style="list-style-type: none"> <li>• Continues to exist unless removed from the Companies Office register (despite changes in control/ownership/management)</li> </ul> <p>Confidentiality</p> <ul style="list-style-type: none"> <li>• Details of limited partners are not publicly available</li> <li>• Limited partnership agreement not publicly available</li> </ul> <p>Flexibility and freedom in drafting the limited partnership agreement (provided it does not contravene the Limited Partnerships Act)</p> <p>Limited partners' capital contributions can be in any form – including cash, skills, or assets (excluding loans)</p> <p>Suited to passive investors, reasons include:</p> <ul style="list-style-type: none"> <li>• Separation between ownership and management/control – the general partner handles management and day to day operations; limited partners simply investors and have no power to bind the LP</li> </ul>	<p>Ongoing statutory administrative obligations, including:</p> <ul style="list-style-type: none"> <li>• Filing annual returns – failing which, the LP will be removed from the Companies Office register</li> <li>• Keeping minutes of meetings</li> <li>• In some cases, preparing and/or auditing financial statements; financial reporting obligations</li> </ul> <p>Certain mandatory provisions in the Limited Partnerships Act cannot be contracted out of, by the limited partnership agreement or otherwise (although less when compared with the mandatory provisions relating to companies)</p> <p>From the general partner's perspective – whilst the LP has limited liability, general partners can be held personally liable for the obligations of the LP (however this can be mitigated by having a corporate general partner)</p> <p>Certain details must be registered with the Companies Office, and are thus publicly available and viewable, including:</p> <ul style="list-style-type: none"> <li>• LP's name</li> <li>• Details of the general partner</li> <li>• LP's registered office and address for service</li> </ul>





<ul style="list-style-type: none"> <li>• The general partner has fiduciary duties to the LP and limited partners – basic duties are prescribed under the Limited Partnerships Act and general agency law, however they can be avoided or added to under the limited partnership agreement</li> </ul> <p>Subject to the limited partnership agreement:</p> <ul style="list-style-type: none"> <li>• There is flexibility to introduce and raise new capital</li> <li>• There is flexibility as to distribution of profits/income; specifically, there is no solvency test requirements</li> </ul> <p><b>Tax:</b></p> <p>LPs are fiscally transparent for tax purposes – each limited partner’s income share is taxed according to its own tax status</p> <p>Tax losses can be passed through, utilised or carried forward</p> <p>No RWT/NRWT payable</p> <p>The LP can register for GST, and as it is a separate legal entity, the LP is liable for GST</p>	<p><b>Tax:</b></p> <p>Loss limitation rule applies (i.e. limited partners’ tax deductions are limited to their contribution to the LP)</p>
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**UNINCORPORATED JOINT VENTURE**

An unincorporated joint venture (JV) is often described as a “creature of contract”. There is no statutory governance, and no statutory obligations or requirements. It exists when an association of participants come together to achieve a common goal, the terms of which are generally recorded in a joint venture agreement or similar contract. You may find this entity option most suitable in the early stages of a business, when there are still uncertainties as to long term prospects and commitments.

A JV is very similar to a partnership. Some of the differences are however significant, most notably the joint and several liability that exists between partners in a partnership. Care must therefore be taken to ensure that the joint venture agreement is carefully drafted to be consistent with the characteristics of a JV and not otherwise deemed to be a partnership. A key characteristic differentiating a JV from a partnership is that participants in a JV maintain their independence. A common reason that a JV may be deemed to be a partnership (where that may not have been



the parties' intention) is when an element of joint management or liability exists.

Notable advantages and disadvantages of JVs are as follows:

Advantages	Disadvantages
<p>Flexibility and freedom in drafting joint venture agreement – no statutory requirements</p> <p>Subject to the joint venture agreement, no joint liability (as is the case with partnerships)</p> <p>No registration requirements</p> <p>No statutory ongoing administrative obligations</p> <p>Confidentiality – no registration requirements whatsoever</p> <p>Subject to the joint venture agreement:</p> <ul style="list-style-type: none"> <li>• The participants’ capital contributions can be in any form – including cash, loans, skills, or assets</li> <li>• Participants own a proportionate share in the JV’s assets as tenants in common</li> <li>• There is flexibility to introduce and raise new capital</li> <li>• There is flexibility as to distribution of profits/income; specifically, there is no solvency test requirements</li> </ul> <p><b>Tax:</b></p> <p>JVs are fiscally transparent for tax purposes – each participant’s income share is taxed according to its own tax status</p> <p>Tax losses can be passed through, utilised or carried forward</p> <p>No RWT/NRWT payable</p> <p>Loss limitation rule does not apply</p>	<p>The JV does not have a separate legal identity</p> <p>No limited liability protection – participants can be personally sued and held liable (however indemnities can be provided for in the joint venture agreement)</p> <p>There is a very fine line between unincorporated JV and partnership – care must be taken in drafting the joint venture agreement, including:</p> <ul style="list-style-type: none"> <li>• Ensuring that management decisions are made independently of the participants</li> <li>• A clear lack of partnership or agency</li> </ul> <p><b>Tax:</b></p> <p>As a JV is not a separate legal entity, participants are jointly and severally liable for GST obligations</p>



The JV can register for GST

**Incorporated joint venture (JVC)**

Incorporated Joint Ventures (JVC) in New Zealand effectively take the form of a company (as discussed above). The same governance, requirements, advantages, and disadvantages apply.

**TRADING TRUST**

Trusts are relatively common in New Zealand, especially in a family setting. A trust formed and existing for a business purpose is referred to as a ‘trading trust’.

As with any trust in New Zealand, a trust requires a settlor, at least one trustee, and at least one beneficiary, and is governed by a specifically drafted trust deed and the Trustee Act 1956 (‘Trustee Act’). Please note: the Trustee Act will foreseeably be replaced by the Trusts Bill, which is intended will inter alia clarify and simplify trust law in New Zealand.

The settlor is the person or entity which establishes the trust – they appoint the

trustees and beneficiaries, and contribute the initial capital. The trustees are effectively the agents for the trust. They handle all the management and day to day operations, including distribution of income to the beneficiaries, and get no direct benefit from the trust. Often a company is specifically enacted to take on the role of trustee, referred to as a ‘corporate trustee’. As the name suggests, the beneficiaries of the trust receive the benefits (i.e. income and assets) of and generated by, the trust.

Trading trusts share many of the advantages and disadvantages of partnerships and joint ventures. Similarly trusts have no registration requirements and little statutory obligations and requirements, which mean benefits of confidentiality and flexibility. However, trusts are not separate legal entities and do not have limited liability protection.

Notable advantages and disadvantages of trading trusts are as follows:

<b>Advantages</b>	<b>Disadvantages</b>
<p>Flexibility and freedom in structuring the trust and drafting trust deed – no statutory requirements</p> <p>No registration requirements</p> <p>No statutory ongoing administrative obligations</p> <p>Confidentiality – no registration requirements whatsoever, and the trust deed can remain confidential</p> <p>In the case of a corporate trustee, benefits associated with companies would apply in respect to the trustee, such as limited</p>	<p>The trust does not have a separate legal identity</p> <p>The trust cannot own property or assets in the trust’s name – ownership of all property or assets are recorded in the name of the trustee(s)</p> <p>No limited liability protection – the trustee (as effectively the agent of the trust) can be personally sued and held liable (however this can be mitigated by having a corporate trustee)</p> <p>Limited existence – a trust can only exist for a maximum of 80 years (anticipated to</p>



<p>liability</p> <p>Flexibility to introduce/raise new capital</p> <p>Flexibility as to distributions of profits/income to beneficiaries; specifically, there are no solvency test requirements</p> <p>From the beneficiaries’ perspective, trustees have fiduciary obligations to the beneficiaries and the trustee can be held personally liable for a breach of obligations and trust (from the trustee’s perspective, this can be mitigated by having a corporate trustee)</p> <p><b>Tax:</b></p> <p>The trust is not a separate entity for tax purposes, and the trust’s profit and income is therefore either taxed at a flat rate of 33% on income deemed trustee income or at a rated based on the beneficiary’s tax status on income deemed beneficiary income</p> <p>Tax losses remain at the trust level and can be utilised or carried forward by the trust</p> <p>No RWT/NRWT payable</p> <p>Loss limitation rule does not apply</p> <p>The trust can register for GST</p>	<p>increase to 125 years under the Trusts Bill)</p> <p>Ongoing statutory administrative obligations, including:</p> <ul style="list-style-type: none"> <li>• Record keeping</li> <li>• Updating property titles when trustees change</li> </ul> <p>In the case of a corporate trustee, disadvantages associated with companies would apply in respect to the trustee</p> <p>There are some perceived complexities and uncertainties relating to trust law from an overseas perspective</p> <p><b>Tax:</b></p> <p>Tax losses cannot be passed through to beneficiaries (because they remain at the trust level)</p>
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**TAXATION**

In New Zealand, the Government collects and administers tax through the Inland Revenue Department ("IRD"). The IRD collects tax under two primary pieces of legislation. They are:

1. The Income Tax Act 2007; and
2. The Goods and Services Tax Act 1985.

The latter is a consumption tax commonly called "GST", charged at a flat rate of 15%. In addition,

import tariffs, miscellaneous excise duties and rates are collected.

Some of the important features of the New Zealand tax system and policy environment are that:

1. There is generally no capital gains tax (however what is effectively a capital gains tax can apply to some foreign debt, financial arrangements, and property investments);



2. There is no employee payroll tax;
3. There is no social security tax;
4. New Zealand is a party to numerous double agreements – currently 39; and
5. Personal tax rates vary, depending on income;
6. A New Zealand resident company is taxable on its worldwide income at a flat rate of 28%;
7. All companies, whether resident or non-resident, are taxed at the same rate (however it should be noted that an overseas company is taxed at the same rate but only in respect of its income that has a New Zealand source)

### FINANCIAL SERVICE PROVIDERS (FSP)

Any New Zealand entity or person in the business of providing ‘financial services’ (in NZ or overseas) must register as a Financial Service Provider (FSP) on the Financial Service Providers Register (FSPR).

#### Financial services

What qualifies as a ‘financial service’ is vast, and is defined in the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

Financial services include:

1. Financial advisors,
2. Brokering;
3. Providing credit under a credit contract;
4. Issuer or offeror of financial products;
5. Changing foreign currency;
6. Trading financial products or foreign exchange on behalf of other persons.

#### Registration process

The FSPR is a branch of the Companies Office. Registration as an FSP is an online process. It is somewhat more involved and sometimes lengthy than the process for registering a company or

limited partnership.

Points to note are that:

1. Once your business entity is incorporated/established, you can then apply for FSP registration
2. The complexity of the registration process (and what is required) varies depending on the relevant financial service(s), in most cases however:
  - (a) It will be mandatory for the FSP to join an approved dispute resolution scheme; and
  - (b) The entity will be expected to be aware of and agree to comply with New Zealand’s anti-money laundering and countering financing of terrorism requirements.

### OVERSEAS INVESTMENT

Generally New Zealand is open to overseas investment, and restrictions and requirements on investment are much the same for overseas persons or entities as they are for New Zealand persons or entities.

Recently a requirement was introduced for every person acquiring land to be registered with IRD.

There are certain exceptions which require the consent of the Overseas Investment Office (‘OIO’) and which are set out in the Overseas Investment Act 2005 (‘Overseas Investment Act’).

The Overseas Investment Act applies to three categories of investment by overseas persons in New Zealand to the following (as defined in the Act):

1. Sensitive land (which includes farmland greater than 5 ha, reserves, islands, and historic land);
2. Significant business assets (generally assets, shares, or securities greater than





\$100m); and

3. Commercial fishing quotas.

The Overseas Investment Act requires consent to be obtained for a transaction before the overseas investment is given effect under the transaction. Overseas persons are all persons who are not ordinarily resident in New Zealand, any company that is not incorporated in New Zealand and any company incorporated in New Zealand the shares of which are controlled as to 25% or more by an "overseas person".

Every person or associate making an overseas investment must apply to the OIO for consent to the overseas investment transaction. A considerable amount of information is required to be included in any application for consent, including information about the applicant, details of the investment, the rationale for the investment and evidence that the investment meets the relevant criteria in the Overseas Investment Act. The consent process takes, on average, three months. If the application involves Sensitive Land it will most likely be referred to the Ministers of Finance and Land Information for final approval.

## IMMIGRATION

It is not necessary for you to have a visa to invest in New Zealand.

However, should you wish to work or reside in NZ, you would require:

1. New Zealand or Australian citizenship; or

2. New Zealand or Australian residence visa; or
3. A New Zealand work visa.

### Available visas

New Zealand's immigration laws are regularly changing. Generally, however there are always specific work visa or residence visa categories suitable for those wishing to work or reside in New Zealand.

Generally, most relevant for overseas investors are the following visa categories:

1. Entrepreneur work visa / residence visa (applicable to those seeking to 'self-employ' in New Zealand)
2. Investor category residence visa (applicable to those wanting to gain New Zealand residence through investment in NZ), which is subcategories into:
  - (a) Investor Plus (Investor 1) category – requires a minimum investment in New Zealand of NZ\$10 million;
  - (b) Investor (Investor 2) category – requires a minimum investment in New Zealand of NZ\$3 million.



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# INTERNATIONAL LAWYERS NETWORK



ØKLAND & CO

ESTABLISHING A BUSINESS ENTITY IN NORWAY

ILN CORPORATE GROUP



## ESTABLISHING A BUSINESS ENTITY IN NORWAY

### Different Business Entities

#### 1.1 Introduction and outline

Enterprises in Norway may be organized in several ways; the most common are limited liability companies, partnerships, and sole proprietorship.

When selecting the appropriate business form in Norway the choices are mainly between the above mentioned three structures. If the activities are of a non-profit or voluntary nature, a club, association, or foundation may also be an alternative.

The key factors to consider when choosing a particular business entity type are volume, risk, earning potential and taxation. Also, the availability of a particular entity type depends on the number of owners. A single owner may operate as a sole proprietor or a limited liability company. If there are two or more owners of the business, by definition it cannot be a sole proprietorship, but it may be an unlimited or limited partnership, or a limited liability company.

#### 1.2 Limited liability company

In Norway, limited liability companies are independent legal entities, like limited companies in the U.K. and US. A limited liability company can be organized either as a private or as public company.

Public company shares may, contrary to private company shares, be negotiable on stock markets. The minimum share capital for a private company is NOK 30 000,-. For a public company it is NOK 1 000 000,-.

The owners of a limited company have no personal responsibility for the company's obligations. Their economic risk is limited to the share capital contributions made to the company. Creditors can only file claims against the company, not the shareholders.

If your business operates on a medium to large scale with some risk, we recommend that you organize as a limited liability company.

#### 1.3 Partnerships

Partnerships may be organized as an unlimited liability partnership or a limited liability partnership. Both are an association of two or more partners who are jointly or severally liable for the enterprise's total liabilities.

The unlimited liability partnership in Norway is called an "ANS". In an ANS partnership, the partners are personally liable for the enterprise's total debt (joint and several liability). Debt that one partner is unable to pay may be claimed in full from any one of the other partners.



The limited partnership is called "DA". The partners jointly are personally liable for the enterprise's total liabilities, but each partner is only liable in proportion to his or her ownership interest in the partnership. Creditors cannot claim coverage for more than 10 % of their debt from a partner who has a 10% ownership in the partnership, even if the other partners are unable to settle their part of the debt.

Another form of limited partnership is "KS". This type of business is a hybrid of unlimited liability partnership's and limited liability companies. One or two "general partners" have unlimited personal liability covering the partnership's



obligations. The "KS" is a legal entity and is itself liable for all its obligations.

### 1.4 Sole proprietorship

Sole proprietorship is a form of enterprise in which a 'physical person' is liable for a business. This means that he or she is financially liable for all the enterprise's liabilities and obligations.

The owner (physical person) has the full right to decide over the enterprise. There are no special rules or separate acts of law regulating sole proprietorships. However, if the enterprise has more than 30 employees, certain special requirements apply.

If your business operates on a small to medium scale with little volume and risk, we recommend that you organize the business as a sole proprietorship.

## 2 Steps and timing of establishment

### 2.1 Introduction

When establishing an enterprise in Norway, the founder is required to notify the authorities. The same applies when a company takes on employees, and when it starts to sell goods or services that are liable to VAT.

In all of these situations, the enterprise must register with the Brønnøysund Register Centre's Central Coordinating Register for Legal Entities. The various agencies collaborate on exchanging information, so that one can fill in and send the form *Coordinated Registration Notification* to notify the Brønnøysund Register Centre, the Norwegian Labour and Welfare Administration (NAV) and the tax office at the same time.

In the following we will give a brief overview of steps to incorporate before establishing an enterprise.

### 2.2 Limited liability company (AS/ASA)

The procedure for forming a limited liability company starts with drawing up a memorandum.

The memorandum must state the company's articles of association and bylaws, specify the company name, state the names and other relevant details of the founders, number of shares to be subscribed for by each founder, the amount payable for each share and the time of settlement.

The memorandum also must state the members of the Board. Furthermore, it should indicate whether the company should have an auditor and if so, the name of the auditor.

The company must be registered in the Brønnøysund Register Centre's Central Coordinating Register for Legal Entities within three months after the memorandum is signed. At this point it is a requirement that payment of the company's capital is made to the full extent.

Finally, the company must have an official name containing the abbreviation "AS" for private limited liability company, and "ASA" for public limited liability company.

### 2.3 Partnerships (ANS/DA)

The procedure for forming a partnership, involves that the participants enter into a partnership agreement. The partnership is established when the partnership agreement is signed by all participants.

No equity is required to start a partnership company. This is because the personal responsibility of the participants is deemed sufficient to protect creditors' commitments. It depends upon the participants' own assessment of funding requirements whether and to what extent they should have initial capital.

The partnership agreement must be registered in the Register of Business Enterprises. The partnership must have an official name containing the abbreviation "ANS" or "DA".

### 2.4 Partnerships (KS)

The procedure for forming a (KS) partnership is like the procedures used when forming an ANS or a DA. Unlike the ANS and DA, each limited partner





must make a deposit of at least 20,000 NOK within a specified time limit when establishing the company.

A limited partnership must have a certain partnership capital, divided into one or more general partner shares and one or more limited partner shares. At least two-fifths of the share capital shall be bound capital, which shall be paid to the company, and which the participants cannot freely dispose of. The general partner must make a deposit amounting to a minimum one tenth of the share capital, own at least one tenth of the Company's net wealth at any time and have at least the same share in profits and losses.

The agreement must be registered in the Register of Business Enterprises. A "KS" cannot be registered until at least one-fifth of each participant's contribution obligation has been paid to the company. Furthermore, it is required that an additional one fifth is paid within two years after the foundation. The partnership must have an official name containing the abbreviation "KS".

## 2.4 Sole proprietorship (ENK)

The formal requirements to form a Sole proprietorship are that the owner must be 18 years of age. He or she does not have to reside in Norway. However, the enterprise is required to have an address in Norway. The owner of a sole proprietorship is not obliged to set aside funds (capital contributions) for the enterprise, since he or she in any event is personally liable.

For tax purposes, a sole proprietorship is assessed together with the person who owns it. This means that the net profit of the business is liable to tax as part of the owner's total income, including, for example, income from employment. Likewise, the net loss will be deductible.

All sole proprietorships can register free of charge with the Central Coordinating Register for Legal Entities, and will then be assigned an organization

number. Sole proprietorships are also entitled to register with the Register of Business Enterprises. This is subject to a charge.

If a sole proprietorship has at least five employees or is a wholesale or retail enterprise, registration with the Register of Business Enterprises is mandatory. Upon registering with the Register of Business Enterprises, the enterprise will be issued a certificate of registration.

The name of the sole proprietorship must contain the surname of the owner.

## 3 Governance, Regulation, and Ongoing Maintenance

### 3.1 Requirements for local shareholding/directors

#### 3.1.1 Private limited liability companies

A limited liability company (AS) must have a board of directors.

As a rule, a limited liability company shall have a board consisting of at least one member. The company may have a general manager. If the company does not have a general manager, the chairman of the board is responsible for the day-to-day management of the company.

The Limited Liability Companies Act contains detailed rules relating to; the company's board of directors, the board's responsibilities, appointment of a general manager, election of board members and deputy board members, the board's duties, term of office, resignation and removal before the end of the term of office, and remuneration of board members.

#### 3.1.2 Public limited liability companies

A public limited liability company (ASA) must have a board of directors consisting of at least three members, and if the company has a corporate assembly, the board must have at least five members. The board of directors is





subject to a requirement for gender representation. The company is also required to have a general manager.

### 3.1.3 Partnerships

The partnership meeting is the highest authority of partnerships. There is no requirement for the partnership to have a board of directors or a managing director. Should the partners decide to have a board of directors or a managing director, the Norwegian Partnerships Act contains rules for their organization.

All the partners are authorized to sign on behalf of the company, unless otherwise stipulated in the partnership agreement or where there is a board of directors. All partners are eligible to vote at the partnership meeting, and all decisions must be unanimous, unless the partnership agreement provides otherwise.

In a "KS", the partners are the limited partnership's highest authority. However, unlike in the unlimited liability partnership, the partners cannot participate in the administration of the partnership. The limited partners must leave the day-to-day administration to the general partner(s) or the board of directors.

## 3.2 Minority shareholders' rights and protection

### 3.2.1 Limited- and public limited companies

In limited liability companies, it is not unusual that a majority and a minority disagree on how to run the company. This is because the basic principle of the Corporation law is that decisions are made by majority vote. A minority must generally accept the majority's decision.

Norwegian Private Limited Liability Companies Act, however, has some rules that protect the minority. The law includes, among other

things, rules for "starvation" of the minority, the right to require notice of an extraordinary general meeting, the right to require an investigation, the right to demand a new election of auditors and the right to assert claims on behalf of the company. Most of these rights require a minority stake of at least 10% of the share capital.

### 3.2.2 Partnerships

In partnerships, all partners are members of the partnership meeting. For the partnership meeting to reach a decision, the decision must be unanimous. Unless otherwise agreed to, company shares can only be transferred to a new owner with the consent of all the other participants. However, each participant can, with six months written notice, terminate its participation and demand to be released by the company.

## 4 Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions

### 4.1 Possible barriers for an offshore party

There is freedom of establishment for businesses in Norway. That means that you do not have to reside in Norway in order to set up a business here. If you wish to establish and operate a business, you need to have a Norwegian D-number and a Norwegian business address. A D-number is a temporary number assigned to, but not limited to, foreign nationals liable for tax in Norway.

If you do not have employees, or do not reside in Norway, you must have a Norwegian representative who is liable for the payment of direct and indirect taxes.

If no economic activity is being conducted, the contact person may reside abroad.

If you wish to start a sole proprietorship, you must register with the police or with a service center for foreign employees. This does not apply if you are from another Nordic country.



If you come from a country outside the EU/EEA area, a special residence permit may be obtained if you wish to set up business as self-employed in Norway.

## 4.2 Possible capitalisation obligations

### 4.2.1 Limited liability companies

To set up a new limited liability company, the founders must complete the above-mentioned procedures before the business can start to operate. The purpose of the formal requirements is to ensure that funding, liability and rights are unambiguously agreed up on between the founders, and to provide adequate security for customers and suppliers.

The limited company must have a share capital of at least NOK 30 000. Before registration, an auditor or a financial institution must confirm that the share capital has been paid in full. The notification to the Register of Business Enterprises shall confirm that the company has received the share capital contributions. If the share capital contributions are to be paid exclusively in cash, a financial institution may confirm that payment has been made. The company may cover the formation costs, but the costs must not exceed the share capital contributions.

A public limited liability company must have a share capital of at least NOK 1,000,000.00, and the company must have a board of directors consisting of at least three members. The board of directors is subject to a requirement for gender representation. The company is required to have a general manager.

### 4.2.2 Unlimited liability partnership and sole proprietorship

In Unlimited liability partnerships, it is up to the partners to agree on whether to make partnerships contributions. The law does not require such contributions. The partners may also agree to contribute assets other than cash, for example objects for use in the business

activities. In a partnership, the capital contributions are not as important in relation to the outside world as the situation is with regard to a limited company. The partners must in any case use private funds to cover any debt, if necessary. It is therefore important that the partners make sure that sufficient capital has been set aside to secure the company financially. That will reduce the risk of any of the partners having to use private funds to cover debt. It will also reduce the likelihood of conflicts between the partners.

In limited liability partnership's (KS), the partners must make partnership contributions as mentioned above. For the general partner(s), the situation is otherwise quite like the situation regarding unlimited liability partnerships. The limited partner's role, however, is far more passive than the role of a participant in the ANS. A limited partner has only a limited liability for company debts. This means that he / she cannot be held personally responsible for obligations incurred by the company, and that he / she is not obliged to provide higher contributions to the company than what is required by the foundation of the company.

In a sole proprietorship, the proprietor, who is a physical person, is liable for the business. This means that he or she is financially liable for all the enterprise's liabilities and obligations. The owner is not obliged to set aside funds (capital contributions) for the enterprise, since he or she in any event is personally liable.

### 4.2.3 VAT

Foreign businesses that start up business activities liable to VAT in Norway must calculate and pay VAT in the same way as Norwegian companies.

VAT is payable on all sales of goods and services, except those that have been specifically exempted by law. Certain goods



and services are exempt from VAT on sales, or subject to a so-called 'zero rate'. Among other things, this applies to the sale of goods and services to other countries, to certain ships and aircraft and for use in offshore petroleum activities. Businesses with these types of sales must be registered in the VAT Register.

The importation of goods and services to Norway is also liable to VAT. Norwegian Customs and Excise collect VAT on the imported goods. VAT on imported services is subject to certain limitations: Businesses and public institutions must calculate and pay VAT on purchases of services provided from abroad. In other words, it is the recipient's duty to calculate and pay VAT in such cases. Examples of services that can be remotely provided include electronically provided services, consultancy services and various information services.

The standard VAT rate is 25%. A VAT rate of 15% is levied on the sale of food. The rate is 8% for passenger transport. The same applies to hotels and other businesses that rent out rooms, apartments, and vacation homes to tourists.

Foreign businesses that sell goods or services in Norway, must register with the VAT Register when the value of sales and withdrawals liable to VAT exceeds NOK 50,000 during a 12-month period.

Foreign businesses that sell goods or services in Norway without having a place of business or a place of residence here must be registered through a representative. If the foreign national registers through a representative, he or she will have the rights and obligations that follow from ordinary registration in the VAT Register. The representative must have a place of residence or a place of business in Norway.

A foreign business that is registered in the VAT Register (directly or through a representative),

is obliged to comply with all applicable Norwegian accounting legislation. The foreign business has a duty to submit VAT returns to the tax office for each reporting period. Businesses with sales of less than MNOK 1 in the course of a calendar year can apply for permission to submit a VAT return once a year (annual VAT return).

### **4.3 Restrictions on remitting funds outside of the jurisdictions (withholdings, etc.)**

#### **4.3.1 Share dividend**

When a company generates a profit, some of the company's returns may be distributed as dividends to shareholders.

Distribution from Norwegian limited liability companies can only take place subject to the rules relating to dividend, capital reduction, merger or demerger and repayment on dissolution of a company. The general meeting decides whether or not dividends shall be distributed.

Any transfer of value whereby shareholders benefit, directly or indirectly, is classified as a distribution. The value shall be calculated using the fair value on the transfer date.

In partnerships, all profits and losses are shared equally among all partners. There are no restrictions in terms of the shareholders non-distributable equity as there is in limited liability companies. However, there is a formal requirement that the financial statements are approved by a partnership meeting before the distribution takes place.

#### **4.3.2 TAX**

##### **4.3.2.1 Limited liability companies**

The profit from limited liability companies is taxed at a rate of 24%. When profit is being distributed to personal shareholders, tax is calculated after the deduction of a risk-free return, referred to as the shareholder model. This means that a further 29,76% tax is



levied on the profit, after the deduction of the deductible risk-free return.

Foreign shareholders who receive dividends from a Norwegian corporation pay income tax (withholding tax) to Norway at the rate of 25%. Foreign shareholders who have been living in Norway, pay tax on gains from shares in the Norwegian company until five years after that he or she moved from Norway. A tax treaty may limit the right to demand such tax on gains.

#### 4.3.2.2 Partnerships

Partnerships are not separate taxable entities. The partners are responsible for the partnership's tax payments. The net profit is taxed at a rate of 24%. When the profit is distributed to a physical partner, tax is calculated on the distributed amount after the deduction of paid tax. This more or less equals the maximum tax rate in a limited liability company. Any remuneration for work will reduce the calculated profit.

#### 4.3.2.3 Sole Proprietorships

As the proprietor of a sole proprietorship, you are responsible for the enterprise's tax payments. The enterprise is not a separate taxable person. The proprietor pays advance tax for each period as soon as the income arises, and payment forms for advance tax are sent to the proprietor four times a year. The tax office calculates the amount of tax payable based upon the profit for the previous year.

### 5 NUF - Norwegian-registered foreign enterprises – An alternative form of conducting business activities in Norway.

A foreign enterprise that wishes to do business in Norway, can register a branch of the foreign enterprise in Norway.

If a branch is set up in Norway, the foreign company is liable for the business conducted by

the Norwegian branch. If the branch does not operate from a fixed place of business in Norway, and is liable for VAT according to the provisions of the VAT Act, a Norwegian value added tax representative must be registered by the authorities.

If Norway does not have an agreement with the country of the trader on the exchange of information and mutual assistance in the recovery of claims, the representative will be jointly and severally liable for payment of VAT.

The branch will normally be liable to tax in Norway and will otherwise have to comply with Norwegian regulations. In order to employ foreigners, residence permits must be issued.

No equity requirement applies to the establishment of a branch. However, foreign enterprises conducting business in Norway are obliged to register with the Register of Business Enterprises.

### 6 Are you considering doing business in Norway?

If you have any questions on doing business in Norway, we invite you to contact our office and let one of our lawyers assist you. You are always welcome to visit our webpage, [www.oklandco.no](http://www.oklandco.no).

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*The attorneys at Økland & Co DA offer experienced representation and strategic guidance and our goal is to perform a complete and effective service to our clients. We attach large importance to utter quality and to achieve the best result possible to the client.*

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*The law firm Økland & Co DA was established in 1983 and today we are 44 employees, of which 33 attorneys/associates. We are located in Lillestrøm, Oslo, Eidsvoll and Sørumsand.*





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# INTERNATIONAL LAWYERS NETWORK



**QUIJANO & ASSOCIATES**

**ESTABLISHING A BUSINESS ENTITY IN PANAMA**

**ILN CORPORATE GROUP**





## ESTABLISHING A BUSINESS ENTITY IN PANAMA

### Types of Business Entities

The main types of Business Entities in the Republic of Panama are the **Corporations** (*Sociedad Anónima*) and the **Private Interest Foundations** (*Fundación de Interés Privado*). Limited Liability Companies (LLC) may be incorporated as well; however, the corporations represent most of the registrations.

These business entities have the following advantages:

- They offer total secrecy and anonymity;
- There is no requirement to disclose shareholders or beneficiaries;
- There is no requirement to file annual returns or financial statements;
- There is a full exemption from taxation on any business activity or transaction carried outside of Panama;
- Simple ongoing administration;
- The accounting books may be kept anywhere in the world.

However, besides all the benefits listed hereinabove, a **Private Foundation** is a unique form of legal entity, which acts like a Trust and operates like a company.

### Steps and Timing to Establish

#### Steps to establish a Corporation:

- a. The names and domiciles of each of the subscribers of the articles;
- b. The name of the corporation which may be in any language, provided that it does not include any morally sensitive or offensive or objectionable word, and that it is not identical or too similar to the name of an already existing Panamanian corporation.
- c. The name must include either the acronyms 'S.A.', 'CORP.', or 'INC.'; or either the words 'Sociedad Anónima' or 'Incorporated' – in order to indicate the type of Panamanian legal entity.
- d. The purpose of the corporation.
- e. Its authorized capital (which may be expressed in any currency of legal tender that in no case

shall be less than an amount equivalent to ten thousand American dollars (USD \$10,000)

- f. Different types of shares may be issued (in example: with preferential rights)
- g. Amount of shares each subscriber has taken.
- h. The domicile of the corporation and the name and domicile of its resident agent in the Republic of Panama, who may be a juridical person.
- i. Its duration.
- j. The Directors (names and addresses), which can be any natural or juridical person. The law requires a corporation to have at least three directors.
- k. Any other legal clauses the shareholders have convened.

#### Steps to register a Private Interest Foundation:

- a. The name of the foundation, expressed in any language with characters of the Latin alphabet, provided that it does not include any morally sensitive or offensive or objectionable word, and that it is not identical or too similar to the name of an already existing Panamanian foundation.
- b. The name must include the word 'Foundation' to distinguish it from the other natural or juridical persons of a different nature.
- c. The purposes of the foundation.
- d. The initial capital of the foundation.
- l. It may be expressed in any currency of legal tender that in no case shall be less than an amount equivalent to ten thousand American dollars (USD \$10,000)
- m. The members of the Foundation Council (names and addresses), which can be any natural or juridical person. The law requires a foundation to have at least **three members** of the Foundation Council if natural persons occupy such posts; or **one member** of the Foundation Council if a corporate entity is acting as such.



- n. The domicile of the foundation and the name and domicile of its resident agent in the Republic of Panama, who may be a juridical person.
- o. The manner of appointing the beneficiaries of the foundation, among which the founder may be included.
- p. The reservation of the right to amend the foundation charter whenever deemed convenient.
- q. Its duration.
- r. The destination to be given to the assets of the foundation; and the method of liquidation of its patrimony in case of dissolution.
- s. Any other lawful clause that the Founder deemed convenient.

The timing to establish whichever of the two mentioned before is between **24 to 72 hours**.



**Governance, Regulation, and Ongoing Maintenance:**

- Annual accounting records of the corporation do not have to be audited or submitted to the Panamanian authorities since they are not subject to Panamanian accounting or turnover regulations. However, a corporation may keep such accounting records, inside or outside of the Republic of Panama, as the directors consider convenient or necessary for the purpose of reflecting its financial status.
- Private Interest Foundations are statutorily prohibited from engaging in commercial activities, but are also not required to file reports of any kind.

- Corporations have to pay an annual company tax or single annual charge of US\$ 300. Similarly, Private Interest Foundations are subject to pay an annual maintenance tax of US\$ 400. Both taxes respectively must be paid punctually in order to ensure that documents are able to be recorded in the Panama Public Registry and/or that the company or foundation is not removed from the registry. The deadline for the tax payment depends on when the entity was formed. In this regard, entities incorporated between 1st January and 30th June, have until 30th June of every year to pay. On the other hand, entities incorporated between 1st July and 31st December, have until 31st January of the next year to pay.
- Regarding the shareholders and Directors requirements, it is important to note that the real identity of the shareholders of a Panamanian corporation does not have to be registered at the Public Registry. Such information is strictly private and confidential, and it only appears in the Share Registry, which is kept by the Directors/Officers of the corporation. The minimum number of shareholders required for an incorporation is one and they may be of any nationality and residence.
- However, the names and addresses of the directors have to be registered at the Public Registry.
- By virtue of Law No. 85 of 2012, disposition in regard to the split-off and reactivation of corporations were enacted. It is now possible for a commercial legal entity, of any type or nature, to carry out a split-off through the division and transfer of its assets, as a whole or in parts, to one or more already existing corporations or to newly established entities, to be denominated as beneficiaries, which have to be composed by the same partners or shareholders of the entity being split-off.  
  
Also, it is now possible for a corporation to be reactivated by the decision of the majority of its partners, members or shareholders, even when its liquidation process has concluded, in



the event that assets of the corporation resurface and were therefore not included as part of the liquidation process.

- Pursuant to Law No. 47 of August 2013, further amended by Law 18 of April 23, 2015, a regime for the custody of bearer shares of Panamanian corporations was established. Therefore, ***as of 31st December 2015***, Bearer Share Certificates had to be replaced by registered share certificates in the owner's name, or alternatively be delivered to an authorized custodian along with an affidavit stating the ownership of said shares.
- Not complying with the above deadline shall cause the owner of the bearer shares not to be able to exercise before the corporation the political and economic rights inherent to said shares.
- As per Law No. 52 of 27th October 2016, any corporation, limited liability company, private interest foundation and any other legal entity for commercial purposes, constituted under the laws of the Republic of Panama; and engaging in activities and operations that take place or have effects outside of the national territory shall be required to conduct accounting records and keep supporting documentation evidencing such records.
- In addition, a "Certification of Registered Agent" has been established, when a change of registered agent is going to be processed. In these cases, the previous Registered Agent must issue a certification declaring its consent with the change to the new agent and that all its professional fees have been duly paid off; thus, Public Notaries will not close any deed without said Certification of Registered Agent.

For corporations that have adopted the bearer share custody regime, the Board of Directors or the Shareholders' Assembly of the corporation shall pass on a formal resolution, that must be registered against the records of the corporation at the Panama Public registry,

to be able to formally adopt the custody of bearer shares regime referred to in the Law. If the Corporation does not amend its records accordingly, its Articles of Incorporation will be considered automatically amended by virtue of law, prohibiting the issuance of bearer shares.

#### **Foreign Investment, Thin Capitalization, Residency, and Material Visa Restrictions:**

In Panamanian legislation, there are no significant barriers to entry for an offshore party.

The offshore feature of Panamanian corporations has been in force and effect since 1927, as the following exemptions show:

- There is no income tax applicable to income from sources outside of the territory of the Republic of Panama.
- No capital gains tax applicable to capital gains through sources outside the territory of the Republic of Panama.
- No taxation applicable to interests derived by saving accounts or certificates of deposit within or outside of the Panamanian territory.
- No taxation applicable to dividends received from sources outside of the territory of the Republic of Panama.
- Exemption from any obligation to prepare or publish or submit financial statements and full freedom to carry its accounting as and where the corporation may decide when its income arises from sources outside of the territory of the Republic of Panama.
- Any Panamanian corporation whose income arises only from sources outside of the territory of the Republic of Panama does not have to make or submit any tax return, and may conduct its accounting as and where it pleases.
- No special business or investment visa issues.



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# INTERNATIONAL LAWYERS NETWORK



**KAPUNAN & CASTILLO LAW OFFICES  
ESTABLISHING A BUSINESS ENTITY IN THE  
PHILIPPINES**



## ESTABLISHING A BUSINESS ENTITY IN THE PHILIPPINES

### I. Types of business entities

As a general rule, foreign equity is allowed to conduct and participate in business in the Philippines, through any of the following modes:

#### 1. By investing in a domestic stock corporation.

A domestic corporation is a corporation which is organized under Philippine law. It is an artificial being which has a personality separate and distinct from the shareholders, thus, the liability of shareholders is limited only to their capital contribution. Other than their capital contribution, the shareholders' other assets are beyond the reach of the corporation's creditors. Foreign capital may invest in a domestic corporation either by acquiring shares of stock in an existing domestic corporation, or by contributing capital to one that is still in the process of incorporation.

#### 2. By operating through a local subsidiary which may be owned entirely or partially by the foreign business entity.

A local subsidiary is a domestic corporation, incorporated under Philippine law, which is wholly or majority-owned by the foreign business entity. It is considered domestic because of its local incorporation, but is also seen as foreign because of its ownership and the fact that it acts in furtherance of the interests of the foreign "parent" corporation. However, as it is deemed a domestic corporation pursuant to law, it enjoys a legal personality separate and distinct not only from its shareholders, but also from the foreign "parent" corporation.

#### 3. By establishing a domestic branch office or a Philippine affiliate.

A branch office in the Philippines is an extension of an already-established foreign business entity, usually engaged in exactly the same activities as the foreign "parent" corporation. As a mere extension, and operating only through a license, a branch office does not have its own legal personality separate and distinct from the foreign business entity. Because of this, the foreign "parent" corporation will most likely be held responsible for any liabilities which the local branch incurs, even beyond the investment of the foreign business entity. An affiliate office may be an entity which is formed in the Philippines by the foreign business entity, or an existing Philippine business entity which is constituted as an affiliate. It has the same objective as a domestic branch, which is to be an extension of the foreign business entity.

#### 4. By establishing joint venture arrangement with a local corporation.

A joint-venture arrangement is essentially a business partnership between two or more companies, but it is not a legal entity in itself unless the joint venture partners decide to incorporate a joint venture corporation. Usually, but not always, a new corporate entity is born out of the joint venture arrangement, specifically to carry out the business or single undertaking which necessitated such a new corporate entity in the first place.

#### 5. By establishing a Philippine representative office.

A representative office is a promotional or marketing office for a foreign business entity, which acts as a market research





tool, communications interface, or product training arm for the foreign business entity it represents. Because of its limited role disseminating information about the foreign business entity's products and services, it does not have the legal personality to conclude contracts on its own. It also cannot derive income locally from such operations.

**6. By establishing a regional operating headquarters.**

Usually connected to a multinational corporation, a regional operating headquarters is an office which is established in the Philippines for the limited purposes of offering qualifying services to the multinational corporation's affiliates, branches, and subsidiaries, and which are allowed to earn income from these activities only, despite the fact that it is actually considered a foreign business entity under Philippine law.

**7. By establishing a regional area headquarters.**

Also, usually connected to a multinational corporation, a regional area headquarters is an administrative office, tasked with supervising and coordinating the different branch offices, subsidiaries, or affiliates, within the Asia-Pacific region, of such multinational business entity. It is prohibited from earning income from or concluding revenue-generating business in the Philippines, and does not deal directly with the clients and external contacts of the multinational corporation.

**8. By merging or consolidating with an existing domestic corporation.**

A foreign corporation can merge with a domestic corporation, and the surviving corporation absorbs the other corporation.

A foreign corporation may also consolidate with a domestic corporation to form an entirely new entity- a single corporation.

**9. By entering into a management contract with an existing domestic corporation.**

Under this arrangement, a foreign business entity undertakes to manage all or most of the business of an existing domestic corporation for a period not exceeding five years.

**10. By entering into technology transfer agreements.**

A technology transfer agreement is a contract between a foreign business entity and domestic business entity, the object of which is the transfer of knowledge or the transfer and licensed use of all forms of intellectual property. The foreign corporation assumes no risk in the venture of the domestic corporation. Even if the domestic corporation is not profitable, it is still obligated to pay royalties for the use of the foreign technology.

**II. Matters to be Considered when Choosing a Particular Business Entity Type**

**1. The nature of the business.**

It is important to consider the kind of business to be conducted because, under Philippine laws, some businesses require particular business entity types. A bank, for example, must always be a stock corporation. If the business is an energy generation or mining or any other operation which will use the natural resources of the Philippines, then only a joint venture between the government and the private business entity is possible. Furthermore, in such a joint venture, only 40% of the private business entity can be owned by foreign equity. If the brands of



the foreign business entity are already well-known locally, then a domestic affiliate may be the best choice.

If a particular business is controversial or prone to litigation, then some entities, such as the domestic branch office, should be avoided in order to shield the parent corporation from liability. A domestic subsidiary, on the other hand, has the personality to sue and be sued without involving the foreign “parent” corporation.

### **2. The specific activities sought to be undertaken in the Philippines.**

If the objective is simply to promote products and services, or to have an office that will act as a command center for a company’s regional operations, and which office will not engage in the frontline selling of products and services, then establishing a representative office or a regional area headquarters will accomplish those things, without the hassle of incorporation or licensing.

### **3. The tax treatment afforded to each entity.**

The Philippines employs a semi-schedular, semi-global tax scheme. Each activity is taxed differently, and particular activities are taxed differently for different entities. The tax treatment for each entity, thus, must always be part of any due diligence when deciding on the vehicle used to do business in the Philippines. To use the “branch or subsidiary” example, a domestic branch or local affiliate office will always be considered a resident foreign corporation under Philippine tax laws. This is because the branch does not enjoy a separate personality from the foreign entity. Hence, such branch will be taxed only on all of its income derived from

Philippine sources, and on remittances it made to the foreign “parent” company. On the other hand, a domestic subsidiary corporation is, for all intents and purposes, also a domestic corporation. As such, it is liable for income taxes for all revenue, whether sourced from the Philippines or internationally, following the residency rule.

## **III. Steps and Timing to Establish a Business Entity**

More than differences in the steps required to constitute and establish them, it is important to note that different business entities also have different documentary and capitalization requirements, as will be discussed below.

### **1. Domestic Corporation**

A domestic corporation is formed by 5 up to 15 incorporators. A corporate name will have to be officially reserved and the Articles of Incorporation and By-Laws of the proposed corporation will have to be filed with the Securities and Exchange Commission. There must also be a treasurer’s affidavit stating under oath that the required 25% payment and 25% subscription of the authorized capital stock has been complied with. Depending on the nature of the business, certifications are also required from the concerned government agencies which regulate each particular industry. Consularized documents of the foreign corporate entity will have to also be submitted.

Generally, the Securities and Exchange Commission will take about a week to complete the processing of an application for incorporation. For certain companies, endorsements from other government agencies are required and this can add to



the processing time by an additional period of two weeks.

## **2. Domestic Branch Office / Philippine Affiliate**

Since it does not have a distinct legal personality, and only derives from the personality of its foreign “parent” company, the processing of an application for a permit for a domestic branch office requires the submission with the Securities and Exchange Commission of certain documents coming from the parent company which need to be consularized in the Philippines Embassy where the parent company is situated. The processing of the approval can take about two weeks from the submission of complete documentary requirements.

## **3. Joint Venture Arrangement**

In as much as the joint venture arrangement usually results in a new corporation, the same discussion on the incorporation of a domestic corporation must be followed. That means the registration of a new name for the joint venture corporation, as well as the filing of its Articles of Incorporation and By-Laws with the Securities and Exchange Commission.

## **4. Representative Office**

The requirements are the same as with a domestic branch, in that a representative office needs to be registered and licensed with the Securities and Exchange Commission through the submission of documents coming from the foreign company based abroad and duly consularized by the Philippine Embassy in said jurisdiction. The establishment of such an office, however, requires two

certifications, an endorsement, and proof of remittance of capitalization, namely:

- A certification from the Philippine Consulate or Embassy or the Philippine Commercial Office or from the Philippine Department of Trade and Industry office in the applicant multinational corporation’s home country, certifying that said foreign entity is engaged in international trade with affiliates, subsidiaries or branch offices in the Asia-Pacific region and other foreign markets;
- A certification from a principal officer of the applicant multinational corporation that it has been authorized by its board of directors to establish its regional operating headquarters in the Philippines;
- And endorsement from the Philippine Board of Investments; and
- Proof of inward remittance of at least US \$ 30,000.00.

## **5. Regional Operating Headquarters**

Under Philippine law, any multinational company may establish a Regional Operating Headquarters as long as they exist under the laws of another country, and as long as the multinational has branches, affiliates and subsidiaries in the Asia-Pacific Region and other foreign markets.

The establishment of such an office, however, requires two certifications, an endorsement, and proof of remittance of capitalization, namely:

- A certification from the Philippine Consulate or Embassy or the Philippine Commercial Office or from the Philippine Department of Trade and



Industry office in the applicant multinational corporation's home country, certifying that said foreign entity is engaged in international trade with affiliates, subsidiaries or branch offices in the Asia-Pacific region and other foreign markets;

- A certification from a principal officer of the applicant multinational corporation that it has been authorized by its board of directors to establish its regional operating headquarters in the Philippines;
- And endorsement from the Philippine Board of Investments; and
- Proof of inward remittance of at least US \$ 200,000.00.

#### 6. Regional Area Headquarters

The requirements of a regional operating headquarters apply as well to a regional area headquarters, and only the amount of remittance varies, thus:

- A certification from the Philippine Consulate or Embassy or the Philippine Commercial Office or from the Philippine Department of Trade and Industry office in the applicant multinational corporation's home country, certifying that said foreign entity is engaged in international trade with affiliates, subsidiaries or branch offices in the Asia-Pacific region and other foreign markets;
- A certification from a principal officer of the applicant multinational corporation that it has been authorized by its board of directors to establish its regional area headquarters in the Philippines;

- And endorsement from the Philippine Board of Investments; and
- Proof of inward remittance of at least US \$ 50,000.00.

#### IV. Governance, Regulation, Maintenance, and Reporting Requirements

In general, all corporations in the Philippines must submit, annually, a General Information Sheet and an Audited Financial Statement to the Securities and Exchange Commission. This includes branch offices, representative offices, regional area headquarters, or regional operating headquarters, even though they only act for and in representation of a foreign business entity and have no legal personality of their own.

The requirement for local shareholding depends on the industry in which the company will operate in. The Philippines has certain nationalized and partially-nationalized industries, and any entity operating in such industries must be either majority-owned, or wholly-owned, by Filipino citizens.

All corporations are required to have at least 5 up to 15 Directors, the majority of which must be residents of the Philippines. Other entities which are not incorporated under Philippine law, but nevertheless do business in the Philippines, are required to appoint a Resident Agent who resides in the Philippines. The role of the Resident Agent is to be the person authorized, on behalf of the foreign entity, to receive legal notices and processes.

Under Philippine corporate law, all shareholders, regardless of the class of shares, are guaranteed certain voting rights, more commonly known as "fundamental rights". The number and nature of shareholdings notwithstanding, any shareholder in any corporation may always vote on the following matters:



1. Any amendment of the articles of incorporation;
2. The adoption or amendment of the corporation’s by-laws;
3. Any transaction or disposition of all, or substantially all the corporate property;
4. Any initiative to incur, create, or increase the corporation’s bonded indebtedness;
5. Any increase or decrease of the corporation’s capital stock;
6. Any initiative to merge or consolidate of the with another corporation;

7. The investment of corporate funds in another corporation or business; and
8. Dissolution of the corporation.

**V. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions**

Subject to certain restrictions, business entities may be up to 100% foreign-funded. The biggest hurdle will always be the nationality requirements of business entities in certain industries. The restrictions on foreign equity in certain industries are summed up by Philippine foreign investment laws as the “Negative List”.

**LIST A**

**Foreign Ownership is Limited by the Constitution and Specific Laws**

<b>Industry</b>	<b>Allowed Foreign Equity</b>
Mass Media, Except Recording	<b>None</b>
Practice of All Professions	<b>None</b>
Retail Trade, Paid-Up Capital of Less than US\$2,500,000	<b>None</b>
Cooperatives	<b>None</b>
Private Security Agencies	<b>None</b>
Small-scale Mining	<b>None</b>
Utilization of Marine Resources in Philippine Waters, Including The Exclusive Economic Zone	<b>None</b>
Ownership, Operation and Management of Cockpits	<b>None</b>
Nuclear Weapons Trade and Manufacture	<b>None</b>





Biological, Chemical and Radiological Weapons and Anti-Personnel Mines Trade and Manufacture	<b>None</b>
Manufacture of Firecrackers and Pyrotechnics	<b>None</b>
Private Radio Communications Network	<b>Up to 20%</b>
Private Recruitment for Local or Overseas Employment	<b>Up to 25%</b>
Contracts for the Construction and Repair of Locally-Funded Public Works, except: <ul style="list-style-type: none"><li>• Projects covered in R.A. 7718; and</li><li>• Projects which are foreign funded or assisted and required to undergo international competitive bidding</li></ul>	<b>Up to 25%</b>
Contracts for the Construction of Defense-related Structures	<b>Up to 25%</b>
Advertising	<b>Up to 30%</b>
Exploration, Development, and Utilization of Natural Resources	<b>Up to 40%</b>
Ownership of Private Lands	<b>Up to 40%</b>
Public Utilities	<b>Up to 40%</b>
Ownership, Establishment, and Administration of Schools	<b>Up to 40%</b>
Culture, Production, Milling, Processing, and Trading, Except Retailing, of Rice and Corn, and Acquiring Rice and Corn and the Rice and Corn By-Products	<b>Up to 40%</b>
Contracts for the supply of Materials and Goods to Government-owned or Controlled Corporations, Companies, Agencies, or Municipal Corporations	<b>Up to 40%</b>



Project Proponent and Facility Operator of a Build-Operate-Transfer Project Requiring a Public Utilities Franchise	<b>Up to 40%</b>
Operation of Deep Sea Commercial Fishing Vessels	<b>Up to 40%</b>
Adjustment Companies	<b>Up to 40%</b>
Ownership of Condominium Units, Where the Common Areas in the Condominium Project are Co-Owned by the Unit-Owners or by a Corporation	<b>Up to 40%</b>
Lending Companies	<b>Up to 49%</b>
Financing companies regulated by the Securities and Exchange Commission	<b>Up to 60%</b>
Investment houses regulated by the Securities and Exchange Commission	<b>Up to 60%</b>

**LIST B****Foreign Ownership is Limited by Reasons of Security, Defense, Risk to Health and Morals, and Protection of Small and Medium Enterprises**

<b>Industry</b>	<b>Allowed Foreign Equity</b>
Manufacture, Repair, Storage, and Distribution of Products / Ingredients Requiring Philippine National Police Clearance (such as firearms and explosives; may be allowed for non-nationals if for export)	<b>Up to 40%</b>
Manufacture, Repair, Storage, and Distribution of Products / Ingredients Requiring Department of National Defense Clearance (such as tools for warfare; may be allowed for non-nationals if for export)	<b>Up to 40%</b>
Manufacture and Distribution of Dangerous Drugs	<b>Up to 40%</b>
Sauna and Steam Bathhouses, Massage Clinics, and Other Like Activities	<b>Up to 40%</b>



Gambling, Except Those Covered by Investment Agreements with PAGCOR and Operating within Special Economic Zones	Up to 40%
Domestic Market Enterprises with Paid-In Capital of Less Than US\$200,000	Up to 40%
Domestic Market Enterprises which Involve Advanced Technology or Employ at Least 50 Direct Employees with Paid-In Capital of Less than US\$100,000	Up to 40%

### 1. Domestic Corporation

The minimum paid-up capital requirement of a domestic corporation is dictated almost entirely by the industry it seeks to operate in. As expected, insurance, finance, and investment companies have some of the most expensive capitalization requirements in the Philippines. Furthermore, the amount of foreign equity, and whether a company will engage in mostly export sales or domestic sales, will also result in variances in the capitalization requirements.

Setting up a Philippine subsidiary of a foreign entity generally requires a capital outlay of at least US \$ 200,000.00, as per Philippine foreign investment laws. This may be reduced if the Philippine Department of Science and Technology certifies that advanced technologies will be involved in the operations of the local subsidiary, or if it will employ at least 50 direct hire employees.

### 2. Domestic Branch Office / Philippine affiliate

The capitalization requirement for a branch office or Philippine affiliate is the same as a local subsidiary, or US \$ 200,000.00, which, again, may be reduced, if a certification that advanced technology will be used in the operations

of the office, is obtained from the Department of Science and Technology.

### 3. Representative Office

A representative office must be funded, through an initial inward remittance, with at least US \$ 30,000.00 to cover its operating expenses.

### 4. Regional Operating Headquarters

A regional operating headquarters in the Philippines must be capitalized by no less than US \$ 200,000.00.

### 5. Regional Area Headquarters

Establishing a Regional Area Headquarters in the Philippines requires a capital expenditure of at least US \$ 50,000.00 annually to cover operating expenses.

Qualified foreign investors are issued by the Bureau of Immigration, through the Board of Investments, a Special Investor's Resident Visa pursuant to the provisions of the Omnibus Investments Code of 1987. The Special Investor's Resident Visa is a special non-immigrant visa which allows the Visa holder to reside in the Philippines for an indefinite period, if the required qualifications and investment amounts are maintained.



There are generally no restrictions for remitting funds out of the Philippines, if the remittance complies with Philippine banking, finance, and anti-money-

laundering laws. However, depending on the vehicle chosen, there will be tax liabilities for the remittances from the Philippines to foreign jurisdictions.



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# INTERNATIONAL LAWYERS NETWORK



**MGRA & ASSOCIADOS**  
**ESTABLISHING A BUSINESS ENTITY IN PORTUGAL**





## ESTABLISHING A BUSINESS ENTITY IN PORTUGAL

### I. INTRODUCTION

Portugal has circa 10,5 million resident inhabitants and most of its population lives in sunny coastal areas. Important cities include Lisbon, Porto (in the north), Coimbra (in the center), Faro (in southern Algarve), as well as Ponta Delgada (in the Azores) and Funchal (in Madeira).

Portugal is a Republic since 1910, having in force the same Constitution since 1976. The President, the Parliament, the Government, and the Courts are the representatives of the sovereign country, and both the President and the Parliament are chosen through general democratic elections. The Government is normally formed by the party who wins the election for Parliament.

The Constitution separates the Legislative power, which is generally attributed to the Parliament, the Executive power, which lies with the Government and the Judicial power, which is left to the Courts.

Portugal entered into European Union in 1986, is part of the Schengen area and adopted the Euro since its creation, as result of an integration process which last milestone is the Treaty of Lisbon, benefiting from the European Single Market and its four freedoms: goods, capital, services and labor.

Portugal is also a founding member of the Community of Portuguese Language Countries, the international organization that aggregates all Portuguese speaking countries.

Portuguese main industries include tourism, seafare economy, forest, petrochemistry, cement production, automotive, electrical and electronics industries, textile, footwear, furniture, beverages & food industry, leather & cork. Pharmaceutical, IT, renewable energies and aerospace industry are strong upcoming sectors.

With modern infrastructures and technologies,

Portugal is nowadays a business-friendly jurisdiction, and a solid platform to invest in Europe and in Portuguese Language Countries, most of which are emerging countries with vast natural resources, such as Brazil, Angola, Mozambique, and East-Timor.

### II. TYPES OF BUSINESS ENTITIES

#### II.1. General Considerations and Companies Types

The basic legal framework on Portuguese corporate business organization is codified in the Companies Code ("*Código das Sociedades Comerciais*"), the Commercial Registry Code ("*Código do Registo Comercial*"), the Securities Code ("*Código dos Valores Mobiliários*"), the Commercial Code ("*Código Comercial*") and the National Companies Registry Office regime ("*Registo Nacional de Pessoas Colectivas*").

There are five different types of commercial companies in Portugal: the public limited liability company (by shares – "*sociedade anónima*"), the private limited liability company (by quotas – "*sociedade por quotas*"), the partnership ("*sociedade em nome colectivo*"), the limited liability partnership ("*sociedade em comandita simples*") and the limited liability partnership with share capital ("*sociedade em comandita por acções*").

The first two types of companies are by far the most common, while the last three have proven to be less flexible and inadequate for the modern business needs.

#### II.2. The Public Limited Liability Company (PLC)

As previously mentioned, the PLC ("*Sociedade Anónima*" or "S.A.") is one of the two most common investment vehicles used in Portugal with the purpose of establishing business and commercial transactions. It ensures the limitation of shareholders liability to the amount of their investment in the company -



their participation in its share capital - and qualifies these participations as negotiable securities.

Shares may be listed on the Lisbon Stock Exchange (“*Bolsa de Valores de Lisboa*”) or remain under private commerce.

Generally, a PLC must be incorporated by a minimum of five individual or corporate founding shareholders. Exception is made, being required only one founding shareholder, when all outstanding capital stock is subscribed and held by another corporation at the time of incorporation. Also, only two founding shareholders are required when the State, or a State holding company, owns more than 50 % of the capital stock.

Since 2017, company law only allows nominative shares in PLCs in accordance with European Union regulation.

The shares may be represented by book entries or certificates (depending on whether they are represented by registrations in an account or by paper documents).

Decree-Law 49/2010 of May 19, 2010, has introduced in the Portuguese legal scenario, along with the shares with par or nominal value, shares without par value, to facilitate capital increase scenarios.

Thus, a share shall have a minimum value of EUR 0,01 (par value or issue value).

There are two types of shares:

- ordinary shares (“*acções ordinárias*”) which entitle holders to dividends and to a portion of the assets upon winding up, subject to the rights attributed to any existing preferred shares.
- preferred shares (“*acções preferenciais*”) which award special rights to their holders, usually broader rights than the ones attributed to ordinary shares. The bylaws

may authorize the PLC to issue two types of preferred shares:

1. non-voting preferred shares (“*acções preferenciais sem voto*”) which confer, if they have nominal or par value, preferential rights to their holders to receive an annual payment of not less than 5% of the shares' par value, payable as a dividend out of distributable profits. If not, the annual payment is calculated by reference to the value of the issue of the shares reduced of its premium, if any. These shares have also priority over ordinary shareholders in the event of company liquidation. If authorized by the bylaws, corporations may issue non-voting preferred shares up to a maximum of 50% of its registered share capital;
2. redeemable preferred shares (“*acções preferenciais remíveis*”) which are redeemable at a fixed time date or when established by shareholders' general meeting. Only shares which are fully paid up can be redeemable. Redemption must be made at par value or according to shares issue value (in case of shares without par value), unless bylaws provide for the payment of a premium.

Shares in a PLC are freely transferable, except where the respective bylaws set forth restrictions on its transferability. These restrictions may consist of a right of first refusal or pre-emption right in favor of the remaining shareholders and right of prior consent of them or the company. Shares may be transferred by a written agreement or a written declaration of the owner addressed to the keeper of the PLC's share registry (usually the company itself). The bylaws may not prohibit the transfer of shares



otherwise permitted by law, being that transfer may only be restricted within the terms of the relevant legal provisions.

A minimum capital stock of EUR 50.000,00 is required for the incorporation of a PLC. It can be formed either by private subscription of the entire capital stock or through public subscription of the shares.

The share capital of a PLC must be paid up by means of contributions in cash or in non-monetary assets (contributions in kind) and the legal minimum capital must be fully subscribed. However, the capital stock does not have to be fully paid up at the time of its subscription. Indeed, only a minimum of 30% of each shares' nominal value must be satisfied at that time. Within five years of the incorporation, the remaining part of capital stock must be fully paid up.

Generally, a PLC can acquire and hold its own shares, but only up to a maximum of 10 % of its total registered share capital. The voting and economic rights inherent to these shares are suspended if they are owned by the company itself, except for the right to receive the correspondent additional number of shares in case of stock capital increase by incorporation of reserves.

Finally, share capital increases, as any other amendment to the company's bylaws, shall be approved by shareholders' meeting. Nevertheless, bylaws can authorize the board of directors to decide on share capital increases in cash within certain limits.

### **II.3. The Private Limited Liability Company (LTD)**

The LTD ("*Sociedade por Quotas*" or "*Lda.*") has traditionally been the investment vehicle used in Portugal for small business, usually of family origin. The partners are jointly and severally liable to fulfil the company's entire quota

capital, but their liability extends no further than that. This type of business entity does not allow participations to be represented by shares (since capital stock is divided into quotas) and thus may not be listed on the Lisbon Stock Exchange.

In a LTD the identity of the quota-holder is available to public knowledge, since that information is subject to registration with Companies House.

The private limited liability company incorporation needs only two partners, regardless of being individual or corporate. There may exist, however, companies with a sole partner (individual or a company) which are named "*Sociedade Unipessoal por Quotas*" and that basically have the same regime as a regular limited liability company but with certain particularities with respect to the relationship between the sole quota-holder and the company and the possible enlarged liability of the former. Generally, this sort of company is used for small family business.

A minimum quota capital is no longer required to incorporate an LTD company (it used to be EUR 5.000,00). The contribution of each quota-holder does not have to be fully paid up at the moment of the incorporation of the company. Quota-holders may defer the payment of their contributions until the end of the first financial year or until another date to be set forth in the respective bylaws but no longer than 5 years after incorporation. The minimum value attributed to a quota is EUR 1,00.

Generally, a quota can only be transferred by private or public deed under the company's express consent or under court order, unless the prospective transferee is another quota-holder, transferor's spouse, or the following person in line of succession. This legal regime can be differently regulated in the bylaws.



#### II.4. The Single-Member Private Limited Companies (SMLTD)

As referred above, LTD companies may be incorporated by a single partner, whether an individual or another company (“*Sociedade Unipessoal por Quotas*”).

Some legal limitations are set forth: (i) an individual can only be partner of a unique SMLTD, i.e., cannot hold another company of this kind, and (ii) a LTD cannot have as sole partner an SMLTD.

This type of company may be incorporated as such since the beginning or may result from the concentration of all the quotas of a regular LTD in a single quota-holder. This does not prevent the possibility of a SMLTD being converted into a regular LTD if a new partner comes into scene.

The sole quota-holder may appoint other people as managers or manage the company him/itself.

Any agreement between the sole quota-holder and the company shall aim the implementation of the company’s scope and must be executed in written form. Otherwise, such agreements will be deemed as null and void, and the sole quota-holder may be unlimitedly liable for them.

In case the company becomes bankrupt and provided that the sole quota-holder has complied with the above-mentioned rules, his/its personal assets will not be liable for the payment of the company’s debts.

In the remaining aspects, the rules applicable to the regular LTD also apply to this type of company, apart from those intended to a plurality of partners (e.g., general meeting’ resolutions).

#### II.5. Holding Companies

The current legal framework for holding companies is set forth in Decree-Law 495/88, of

December 30, 1988, as amended.

A holding company must be organized either as a PLC (“S.A.”) or as a LTD (“Lda.”) and its corporate name shall include the reference “*Sociedade Gestora de Participações Sociais*” or “SGPS”.

The sole corporate purpose of a holding company legally permitted is to own and manage capital stock (shares or quotas) of other companies as an indirect form of carrying out business activities. Generally, the holding company is required to hold a minimum of 10 % of the capital stock (with voting rights) of its subsidiaries and must keep such participation at least for one year.

However, this rule is subject to several limitations. An SGPS may invest in smaller holdings (less than 10 % of the voting rights):

- up to an amount not exceeding 30 % of the investments made in larger holdings;
- when each participation’s purchasing value is at least of EUR 5.000.000,00;
- when the purchase results from the target company’s merger or demerger; and
- when it has formalized a managerial subordination agreement with the target company, under which the management of the subordinated company’s business activities is entrusted to the SGPS.

Under special circumstances and provided that some requirements are met, the holding company can provide technical management services to all or some of the partially held companies in which the SGPS has a minimum holding of 10 % or with which the SGPS has formalized a managerial subordination agreement.

Depending on the type of investment some holding companies can be subject to Bank of Portugal (“Banco de Portugal”) supervision



along with other non-banking financial institutions or to the Insurance and Pension Funds Supervisory Authority ("*Instituto de Seguros de Portugal*"). Others are subject to the supervision of the Tax Authority ("*Inspecção-Geral de Finanças*").

Bank of Portugal supervision is mandatory where the company holds, direct or indirectly, the majority of voting rights in one or more credit or financial institutions.

Regardless of the legal form adopted, it is required that every holding company appoints a certified chartered accountant or an audit company.

#### **II.6. The Limited Liability Individual Undertaking**

An individual entrepreneur may also limit his liability to the firm's registered capital through the incorporation of a limited liability individual undertaking ("*Estabelecimento Individual de Responsabilidade Limitada*" or "*E.I.R.L.*") which regime is foreseen in Decree-Law 248/86, of August 25, 1986, as amended.

The minimum capital for an EIRL is EUR 5.000, 00, two thirds of which must be paid in cash and deposited in a blocked account with a local bank until the deed of incorporation is registered with the Companies House. Twenty percent of after-tax profits must be allocated annually to a legal reserve until the amount in such reserve corresponds to at least 50 % of the EIRL's registered capital.

#### **II.7. Branches / Representation Offices**

A foreign company intending to conduct business activities in Portugal for more than one year may do so through the establishment of a subsidiary (or affiliate) in Portugal, except if operating under the freedom of provision of services. The subsidiary will have to vest one of the above outlined types of companies, and will be an autonomous legal entity with a separate

corporate personality.

Any foreign company wishing to operate in Portugal without resorting to a subsidiary is legally required to establish a Portuguese branch ("*sucursal*") or other local permanent representation ("*representação permanente*") and to comply with the appropriate registration requirements. Differently from subsidiary entities, branches are not autonomous legal entities nor do they have a separate corporate personality, reason the foreign company will always be liable for its operations and debts in Portugal.

### **III. STEPS AND TIMING TO ESTABLISH**

Anyone intending to incorporate a Portuguese company must apply for the approval of the company's proposed corporate name and for the granting of a taxpayer number with the National Companies Registry Office. Natural persons who intend to incorporate a company must also apply for a Portuguese taxpayer number with Tax Authorities. Individuals with residence outside the EU must have a tax representative in Portugal to be eligible to be registered with Tax Authorities.

Since the last reform of the Companies Code (2006), and generally, public deed of incorporation is no longer mandatory being sufficient a private deed of incorporation, provided that the signatures of the founding partners are duly certified by a public notary or a lawyer. In addition, the referred Reform has introduced the incorporation of companies through electronic tools (e.g., internet).

Before the execution of the company's incorporation agreement, the capital stock should be deposited in a Portuguese Bank, except in case of deferred contributions in the terms mentioned above. Tax Authorities also require companies to have a bank account in a Portuguese Bank. Also, in case the company's capital stock is not fully paid up in cash, the relevant assets (contributions





in kind) should be subject to prior evaluation by an independent chartered accountant, whose report must be referred to in the incorporation deed

Afterwards, company's deed of incorporation must be registered with the Companies House ("*Conservatória do Registo Comercial*"). Upon registration and other official communications (as Tax and Social Security Authorities), the company becomes a separate legal entity capable of having its own assets, rights, and obligations.

The records are kept by the Companies House and are of public access. Certificates disclosing the facts registered for a specific company can be issued at any time (the process has been facilitated since most corporate records are available through web network) and can be issued in both Portuguese and English languages.

All registered corporate facts are also subject to publication in the official website of the Ministry of Justice (<http://publicacoes.mj.pt>).

In Portugal, companies are not, as a consequence of incorporation, required to have any insurance policies. However, if the company has or will have any employees, it must have a worker's accidents insurance policy. Moreover, the carrying out of certain activities will render companies subject to specific mandatory insurance requirements.

Company shall register itself with the Tax Authority and the Social Security Services within 15 days after incorporation and must serve a notice to Portuguese Labour Department whenever a worker is hired by the company.

With the new procedures recently implemented by the Government (called "*Simplex Program*"), it is possible to conclude the incorporation process in a single day.

#### **IV. GOVERNANCE, REGULATION, AND ONGOING MAINTENANCE**

PLC's management and supervision must take one

of the following three forms. The first one, most commonly used in Portugal, refers to an organization formed by a board of directors ("*conselho de administração*") and a sole supervisor or supervisory board ("*fiscal único*" or "*conselho fiscal*"). A second form of organizing corporate management consists of a board of directors containing an audit committee ("*comissão de auditoria*"). It also includes a certified chartered accountant ("*revisor oficial de contas*") for supervision functions. Finally, there is a third form, which comprises an executive board of directors ("*conselho de administração executive*"), a general and supervisory board ("*conselho geral e de supervisão*"), as well as a certified chartered accountant. In addition, a PLC whose shares are listed on stock exchange market must appoint a secretary ("*secretário*").

PLCs with a maximum registered share capital of EUR 200.000,00 may choose to be managed by a sole director ("*administrador único*") rather than having a board.

On the other hand, the shareholders of a PLC gather and vote resolutions in general meetings. They must gather ordinarily once a year or whenever they are convened by the chairman of the general meeting upon request of the management or the supervisory body or upon request of one or more shareholders holding at least 5% of the entire share capital (special meetings). Under specific circumstances, the law also allows the audit committee, the general and supervisory board, the supervisory board and the court to summon shareholders for a general meeting.

The shareholders' meetings must be convened by a notice published in the official website of the Ministry of Justice (<http://publicacoes.mj.pt/>) or, in certain cases when the bylaws foresee such possibility, by registered mail or by e-mail to shareholders which have expressed their prior written consent. The notice shall be published



with at least 1 month or sent 21 days in advance as to the date of the general meeting, and shall mention, amongst other information, general meeting's agenda.

Notwithstanding the above, a general meeting may be convened and held without complying with the referred prior formalities, provided that all shareholders are physically present or duly represented and unanimously express their consent to gather and take resolutions on a particular subject (universal meetings). In addition, Portuguese law also allows shareholders to pass resolutions without all attending physically and simultaneously the general meeting, provided that the resolutions at stake are approved by unanimity of the votes and laid down in writing.

The last reform of the Portuguese Companies Code (2006) introduced the possibility of holding general meetings by resorting to telematic means (combination of telecommunications and informatics – transmission of voice and image in simultaneous is usually required) also called “virtual meetings”. The shareholders and the company can benefit from this new way of gathering provided that the respective bylaws do not prohibit such mechanism.

In a PLC, there is a minimum presence of voting share capital for shareholders to approve valid resolutions - the gathering quorum. For certain relevant decisions, such as bylaws amendments, stock capital increases or reductions, mergers, spin-offs, liquidation and winding up, etc. it is mandatory that the quorum represents one third of the entire share capital on first call.

Resolutions are passed by a simple majority of votes cast of all those attending/represented in the shareholders' meeting, except for those relevant decisions mentioned in the preceding paragraph where a qualified majority of two thirds of the votes cast is required. Bylaws can provide for higher quorums as well as qualify

voting requirements.

Differently, LTD's management comprises one or more managers (“*gerentes*”). As a general rule, an audit committee or a sole supervisor is not mandatory, but the company is allowed to have one. Indeed, the accounts on this type of company do not need to be checked by a certified chartered accountant, unless two of the following limits are exceeded during a period of two consecutive years:

- total balance sheet value: EUR 1.500.000,00;
- total net sales and other income: EUR 3.000.000,00; and
- Average annual workforce: 50.

The majority of the regime of the PLC is applied to LTD general meetings. The main exceptions refer to summons' formalities - notice must be sent by the manager to quota-holders by registered mail 15 days in advance as to the date of the general meeting – and to voting quorum for bylaws amendments and winding up of the company - where a qualified majority of three-quarters corresponding to the capital stock is required, unless the bylaws foresee a higher majority

As far as requirements for local shareholders/directors are concerned, all individuals or corporations holding a participation in a Portuguese company, as well as any director or manager of a Portuguese company must have or apply for a national taxpayer number with the local authorities.

Finally, a brief note concerning licensing procedure: prior to the starting up of any commercial activity in Portugal, the Municipality should be consulted to ascertain whether the planned activity is subject to any special licensing procedure.

Thus, in case the commercial establishment needs a particular license for operating, the Municipality is the entity responsible for monitoring this



process. In fact, Municipal authorities generally have sole jurisdiction on licensing commercial establishments.

Commercial licensing is governed by the legal regime for construction in urban sites, as set out in Decree-Law 136/2014, of September 09, 2014, as amended.

There is a special regime for commercial establishments and warehouses handling food products, as well as other non-food commercial establishments and service providers whose operations involve health and safety risks. These regulations are set out in Decree-Law 48/2011, of April 1, 2011.

Also, the installation and operation of these establishments must comply with the requirements set forth in specific laws, depending on the products traded.

As a general rule, owners are required to obtain authorization from the Municipality or Trade Associations with regard to opening hours, and they must inform the “CRSS - Centro Regional da Segurança Social” (Regional Centre for Social Security) of any workers hired before they start working.

The application for registration of commercial establishments must be submitted with the “DGAE – Direcção-Geral das Actividades Económicas” (Directorate-General for Economic Activities) or the nearest “DRE – Direcção Regional do Ministério da Economia e da Inovação” (regional office of the Ministry of the Economy and Innovation) or with the relevant Trade Association.

The mentioned Decree-Law 48/2011, of April 1, 2011, within the scope of the Simplex Program and aiming to improve the responsiveness of Public Administration in meeting the needs of citizens, with lower costs and promoting safety and speed of business, revolutionized the licensing procedure for certain business premises,

by creating the Zero Licensing (“*Licenciamento Zero*”) figure.

Licenciamento Zero is therefore intended to reduce administrative costs and eliminate licenses, permits, inspections and *a priori* constraints for specific activities, replacing them with systematic actions of surveillance and accountability mechanisms *a posteriori* on the economic agents.

The simplification begins with the creation of a simplified procedure for the installation and modification of food and beverage establishments, trading goods, services and storage.

As a result, previous administrative permission is now completely replaced for a mere prior notification served to the “*balcão único electrónico*” (e-administrative spot), also called “*balcão do empreendedor*” (entrepreneur spot) accessible through the website [www.portaldaempresa.pt](http://www.portaldaempresa.pt).

As mentioned, certain licensing procedures are simplified or eliminated, such as:

- private use of the municipal public domain for certain purposes, such as installing an awning, an exhibitor or other support information, the placement of a planter or a waste container;
- map of office hours and its amendments;
- registration and posting of commercial advertisements, subject to the rules of public space occupation.

Furthermore, the said Decree-Law eliminates the licensing procedure for certain economic activities, according to which a system of prior control is no longer applicable, such as the sale of tickets for public shows in commercial establishments and the performance of auctions in public places.

The installation of an establishment included in



the list annexed to Decree-Law 48/2011 is now only subject to a prior notification addressed to the Mayor and to the General Director of Economic Activities. With this prior notice and payment of the fees due, the owner is allowed to immediately open and operate the establishment, exploit the warehouse or begin its activity, as applicable.

Also, the modification of an establishment due to the change of the activity/service is only subject to a prior notice submitted with the “*balcão do empreendedor*”. As per the closure of business, it must be reported in the following 60 days.

## **V. FOREIGN INVESTMENT, THIN CAPITALISATION, RESIDENCY AND MATERIAL VISA RESTRICTIONS**

### **V.1. Foreign Investment**

Foreign investment in Portugal has strongly increased in recent times, especially since Portugal became a member of the European Union. The necessary adjustments that were made so that Portugal could be included in the founding group of countries of the Euro currency had a strong effect on the Portuguese economy.

This economic stability, together with the its peaceful social environment, as well as tourism’s potential has been decisive for investment in Portugal. In addition, Portugal’s traditional presence in Africa and Brazil, is an advantage in the establishment of commercial contacts and business opportunities across these expanding markets.

Amongst others, note four major advantages to invest in Portugal:

- (i) Strategic access to markets. The combination of Portugal’s economic opening, strong ties with the EU and unique geostrategic location, make it a natural gateway to world markets. Portugal’s ties with the African continent,

Brazil and transatlantic link with the USA provides a low-cost effective internationalization base.

- (ii) Cost competitive, qualified and flexible workforce. Portuguese employees are known for their versatility and commitment to work, along with a positive attitude towards the adoption of new technologies and practices.
- (iii) Excellent environment to live and work. The country has safe urban centers and suburbs. This environment that promotes a freedom impression to anyone that decides to live in Portugal. All major international studies consider Portuguese cities on the top of the ranking for conducting events and conferences.
- (iv) Infrastructure. During the past decades, Portugal has invested heavily in modernizing its communications infrastructure. The result was an extensive network of land, air and maritime route facilities.

We may also enumerate ten other additional reasons to invest in Portugal:

- One of the lowest operational costs in Western Europe;
- A founder member of and full participant in the European Monetary Union;
- A superb investment track record, with many high-tier companies involved in new projects;
- One of Europe’s youngest and most enthusiastic qualified workforces, with first rate training facilities and universities;
- One of the world’s best and most flexible incentives packages;
- High levels of productivity growth in both manufacturing and services;



- A wide range of sites and buildings, including industrial and business incubators facilities, at highly competitive prices which are ready to use;
- High quality support services for investors, both during or after investment;
- One of Europe's best records for industrial relations;
- A high quality of life with one of the old continent's lowest crime rates.

Also, there is a principle of equal treatment between foreign and domestic investors and thus there are no entry restrictions for foreign capital. In fact, the guiding principle of the Portuguese legal framework is to prohibit discrimination of the investment on the grounds of nationality.

Likewise, it is not required to have a national partner and there are no specific obligations for foreign investors to comply with. There are also no restrictions on the profits and/or dividends repatriation.

As Portugal is a member state of the European Union, an entrepreneur planning to invest in the country will neither have to submit to different rules from those governing domestic investment followed by entrepreneurs. Therefore, as a general principle, there is no differential treatment between foreign and domestic investment in Portugal.

Notwithstanding the above, some reporting obligations must be fulfilled: foreign investors in Portugal are bound to report to the investment authorities within 30 days of the date of the investment. Also, in what regards an investment in Madeira or in the Azores, a foreign investor must register with the Planning and Finances Ministry.

In general terms, foreign and local companies are free to invest in any industry. However,

there may be specific requirements, such as the granting of a concession contract when performing activities for the public administration sector. Certain activities, related to certain basic public services (such as treatment and distribution of drinking water or disposal of urban waste) are prohibited for private companies, except when licensed by a public entity through an administrative contract.

Likewise, foreign investment projects must be compatible with specific legal requirements if, in any way, they could affect public order, safety or health. Projects of this nature require an assessment of compliance with statutory requirements and prerequisites established under Portuguese law.

Included in this category are those concerning the production of weapons, munitions and war materials or those which involve the exercise of public authority. They must comply with legally mandatory conditions and requirements, thus requiring specific licenses.

Finally, it should be noted that some activities are subject to authorization restrictions before starting their operations in our territory, such as banking and insurance activities.

Foreign companies are also subject to taxes and other tariffs, including Income Tax ("IRC"), Value Added Tax ("IVA"), Vehicle Tax, Property Tax ("IMI"), among others.

Companies must also respect deadlines regarding social security payments, as well as payments payable to its employees.

The Treaty of the European Union establishes the free movement of capital, resulting in an overall framework of foreign investment within the EU, under the limits set by the subsidiary principle which is without prejudice of the legislation of certain Member States.

All restrictions on capital movements and payments between EU Member States are





prohibited. Member States may, however, take justified measures with the aim of preventing breaches of its own legislation, including taxation and supervision of financial institutions.

EU countries may also provide procedures for the declaration of capital movements for administrative or statistical purposes, and take other justified actions on the grounds of public policy or public security. However, these measures and procedures should not constitute a means of arbitrary discrimination or a simulated restriction on the free movement of capital and payments.

### **V.2. Thin Capitalization**

Generally, Portuguese law allows companies to be thinly capitalized, except for certain types of regulated entities which require a certain amount of paid-up share capital to be awarded with a license to trade (e.g., banks and insurance companies).

In what concerns taxation rules for thin capitalization, please note that where the indebtedness of a Portuguese taxpayer to a non-resident entity in Portugal or in an EU country with whom special relations exists (i.e. special relations exist if the non-resident entity has or can have substantial influence, directly or indirectly, in the management decisions of the resident entity) is deemed excessive, the interest paid in relation to the part of the debt considered excessive will not be deductible for the purposes of assessing taxable income.

Excessive indebtedness occurs where the value of the debts in relation to each of the entities is more than twice the value of the corresponding shareholding in the taxpayer's equity. Any disallowed interest is not re-qualified as a dividend for withholding tax purposes. This means that withholding tax should be levied on the full amount of the interest, including the

interest related to the part of the loan that exceeds the 2:1 debt-to-equity ratio.

In cases where the 2:1 ratio is exceeded, the taxpayer may be able to avoid adjustments under the thin capitalisation rules where it can be shown that the same level of indebtedness could have been obtained with similar conditions from an independent party. Such evidence must be kept in the annual tax file of the company for 10 years. This option is not applicable where the indebtedness is towards an entity resident in a territory considered by Portuguese law as a territory with a clearly more favourable tax regime.

### **V.3. Residency and Material Visa Restrictions**

Today's Law opens the possibility for foreign investors who invest either by themselves or through a company which they own, to apply for a Portuguese residence permit, if they reach a certain level of property investments, capital investments and / or job creation.

Holders of a residence permit for investment activity have the right to family reunification, access to permanent residence permit, as well as the Portuguese nationality, in accordance with the legislation in force, while being able to move freely within the Schengen Area. It also granted the right to benefit of certain public services, such as medical care and public education.

In fact, nationals of other countries who decide to engage in an investment activity, personally or through a company, which lead, as a rule, in the completion of at least one of the following situations in the domestic territory and for a minimum period of five years may benefit from such visa:

- 1) Transfer of capital in an amount equal to or more than 1 million Euro or less, if related to research, artistic, cultural activities or capitalization of small /



- medium companies;
- 2) Creating at least 10 jobs;
  - 3) Acquisition of property of a value equal or more than 500.000 Euro or less, if the property has more than 30 years old and is located in an area of urban renovation.

This situation also covers holders of capital stock in a company based in Portugal or in another EU Member State with a permanent establishment in Portugal, provided their contributory situation is regularized.

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# INTERNATIONAL LAWYERS NETWORK



**GOLDMAN ANTONETTI & CÓRDOVA, LLC  
ESTABLISHING A BUSINESS ENTITY IN PUERTO  
RICO**



## ESTABLISHING A BUSINESS ENTITY IN PUERTO RICO

Puerto Rico offers many advantages to individuals and companies that decide to establish business operations on the Island. These include unique local tax incentives; a strong, dedicated, and skilled bilingual labor force; legal protections afforded as a United States jurisdiction; vantage position as a Caribbean hub and a nexus between the United States, Latin America, and Europe; and highly developed industrial and commercial infrastructure. Fortune 500 companies have established operations in Puerto Rico for many of these reasons.

When starting a new business in Puerto Rico, whether as a new entity or through the expansion of an existing entity, there are many important decisions to be made. Local rules and procedures must be considered as a first step on the road to success. Issues such as financing, corporate structure and governance, tax structure, location selection, intellectual property protection, equipment acquisition, licensing and permitting, contracts, personnel recruitment and retention, and employee benefits are just some of the considerations that must be addressed by an emerging or expanding business. Other matters to assess include federal and local laws and regulations that may apply to particular lines of businesses. Companies interested in entering into governmental contracts must also consider additional requirements such as insurance coverage, bonds, warranties, and other financing provisions and requirements prior to the contract bid or execution. Businesses performing certain activities may also need to consider particular statutes and regulations applicable to those activities.

### **1. Types of business organizations and entities available in Puerto Rico**

The organization and maintenance of legal entities for engaging in commerce is generally governed by the Puerto Rico General

Corporations Act of 2009, as amended (GCA). Puerto Rico's GCA was modeled after the General Corporations Law of the State of Delaware. Corporate elements such as corporate organization, capitalization, and governance requirements generally follow Delaware's corporate practice. The following forms of enterprise are the most common alternatives to establish and operated a business in Puerto Rico.

#### **A. Sole Proprietorship**

A sole proprietorship is a business whose assets are owned by a single individual and not by a separate legal entity. There are no special legal requirements for creating a sole proprietorship. Only one level of taxation applies: at the owner's level and at the owner's tax bracket. The principal disadvantage of this business form is that the sole proprietor will be personally liable for the debts and obligations of the business.

#### **B. Traditional Partnership**

Unlike other legal entities in Puerto Rico, the organization, governance, actions, obligations, and dissolution of a traditional partnership are governed by the Puerto Rico Civil Code. A partnership can be formed by two or more natural or legal persons that decide to bind themselves to conduct and operate a business as partners, with the intention of dividing the profits amongst themselves. Governance and capitalization of the partnership hinge on the partnership agreement which constitutes the partnership itself. Generally, partners have equal interests in the partnership unless the agreement states otherwise. The partnership agreement should also provide details regarding the initial capitalization and provisions for opening the partnership to new partners. Note that although traditional partnerships are separate legal entities from its partners, the partners generally remain



personally liable for the debts and obligations of the partnership. Partnerships are not subject to income tax at the partnership level but rather at the partner's level.

### **C. Limited Liability Partnership**

Limited liability partnerships (LLPs) can be formed by at least two natural persons through the execution of a public deed form before a Puerto Rico notary public which must then be registered at the Puerto Rico Department of State. In general, the partners of an LLP benefit from limited liability exposure for the debts and obligations of the partnership, except for cases where the partner had personal knowledge and/or acted with willful misconduct. LLPs are subject to yearly renewal. Absence of a timely renewal may convert the LLP into communal property, and therefore expose the partners to unlimited liability. LLPs can offer all types of services, including professional services. If professional services are to be offered, all the partners of the LLP must have a license duly issued by the corresponding Puerto Rico instrumentality, and must also have professional liability insurance coverage. LLPs are taxed in the same manner as traditional partnerships.

### **D. Corporation**

The corporation is one of the most commonly used business forms in Puerto Rico. As noted before, the legal provisions for the organization and governance of a corporation in Puerto Rico mirror the Delaware corporate model, which is widely used in the United States. Puerto Rico corporations can be organized for-profit and not-for-profit purposes. A corporation is a separate legal entity independent from its shareholders, whose personal responsibility for the debts and obligations of the corporation are limited to their capital contribution. Corporations' income is subject to taxation at two levels: the corporation is taxed at the

corporate level on their net income while the shareholders are subject to income tax at their personal level on dividends distributions received from the corporation. In general, corporations are governed by a board of directors, with appointed officers managing daily business operations. Corporations are subject to strict corporate governance compliance requirements. A not-for-profit corporation can be organized by one or more members and could qualify for tax exemption.

### **E. Professional Service Corporation**

A professional service corporation (PSC) is an entity that can be formed by one or more shareholders, whose business is limited to render a professional service. Under the GCA, professional services are defined as services for which a professional license is required, such as certified public accountants or attorneys-at-law. All shareholders and officers in a PSC must be licensed to render the same professional service in Puerto Rico. PSCs are subject to the same general corporate governance rules as regular corporations. As in corporations, the shareholders of PSCs benefit from limited liability, except when professional liability, negligence, or willful misconduct has been proven to have occurred while they are rendering the service. PSCs are also subject to taxation at two levels in the same manner as regular corporations.

### **F. Limited Liability Company**

Limited liability companies (LLCs) comprise the most recent alternative available to individuals who wish to engage in business in Puerto Rico. In essence, LLCs are a hybrid between a partnership and a corporation. LLCs are constituted by members, rather than shareholders, who own an interest in the entity instead of shares. LLCs can be formed by one or more members (who can be natural or legal persons). The constitutional document of an





LLC is its operating agreement. The LLC operating agreement provides for the company's governance, capitalization requirements and the purchase or sale of company interests. Puerto Rico law provides members with a wide degree of freedom to decide on an LLC's governance and structure. Internally, LLCs can operate as a partnership or as a corporation, or as a combination of both. As opposed to corporations, LLCs are not required to file annual reports although payment of an annual fee is required. While LLCs are subject to taxation at two levels in the same manner as regular corporations by default, they can elect to be treated as partnerships for tax purposes. Note that partnership tax treatment will be mandatory in certain circumstances. LLCs can be organized for profit and not-for-profit businesses. LLCs can be also organized to render professional services, subject to most of the limitations of the PSCs.

**2. Brief overview of steps to incorporate/constitute each type of entity**

**A. Basic requirements**

The permitting requirements for businesses establishing operations in Puerto Rico vary, depending on the particular operations in question and the company's needs and growth expectations, among others. The basic federal and local permits, authorizations, or licenses required for most businesses include:

1. **Business Authorization:** Most entities (corporations, LLCs and LLPs) must register with the Puerto Rico State Department before commencing operations. We recommend ensuring the availability of a desired corporate name prior to registration with the Corporations Registry, an office within the Puerto Rico Department of State. All legal entities registered with the State Department have annual reporting and/or

annual fee obligations. Most of these filings and fee payments are due on or before April 15.

- 2. **Federal Employer Identification Number:** New businesses must apply for an employer identification number (EIN) with the U.S. Internal Revenue Service (IRS). The EIN is used for federal and local tax purposes, including Medicare and Social Security taxes as well as Puerto Rico income taxes.
- 3. **Puerto Rico Department of Treasury Notification:** The EIN must be notified to the Puerto Rico Department of Treasury (PRDT) along with copy of the certificate of incorporation. Businesses seeking to engage in trade or commerce in Puerto Rico must register with the PRDT Registry of Business at least 30 days prior to commencing operations.
- 4. **Municipal License Tax (Patente Municipal, as it is commonly referred to in Spanish):** Puerto Rico law allows municipalities to impose and collect municipal license taxes based on the volume of business of up to 0.5 percent of gross receipts. Entities and individuals that establish businesses in Puerto Rico must apply for a municipal business license in the corresponding municipality within 30 days of commencing operations. Upon compliance with the municipality's requirements, the Company will obtain a provisional license, which exempts the company from paying tax during the first semester of operation (note that semesters are based on the government's fiscal year — July 1 through December 31 or January 1 through June 30). Please find additional detail in the Tax Overview section below.
- 5. **Unemployment and Disability Identification Number:** Businesses must obtain an unemployment and disability



account number assigned by the Puerto Rico Labor and Human Resources Department (PRDOL), which administers unemployment insurance. Temporary disability insurance may be obtained privately; proof of such insurance must be filed with the PRDOL. This requirement may also be met by obtaining coverage from the Puerto Rico Non-Occupational Disability Insurance Bureau (“SINOT” for its Spanish acronym.)

- 6. **Worker’s Compensation Fund:** All employers are required by law to purchase a workers’ compensation insurance policy issued by the State Insurance Fund Corporation. Insurance premiums vary in accordance with the level of risk assigned to the various categories of employees. Employers with active policy coverage have absolute immunity from civil liability stemming from employees’ occupational accidents or illnesses, unless when intentionally caused by the employer.
- 7. **Sales and Use Tax Registration:** Puerto Rico law imposes a sales and use tax on the sale of taxable goods and services. Accordingly, all persons conducting business in Puerto Rico must register as a merchant with the Puerto Rico Treasury Department 30 days prior to commencing operations. A separate registration with the local municipality may also be required, depending on the municipality in which the company will establish its business. Once registered, businesses will be required to file a return and remit any tax collected on or before the tenth day of every month.
- 8. **Bidders’ Registry:** All natural persons or legal entities who wish to provide goods and/or nonprofessional services to the executive agencies and public corporations of the Commonwealth of Puerto Rico, excluding the Public Private Partnership

Authority, the Office of Government Ethics, the Puerto Rico Institute of Culture, the University of Puerto Rico, the Planning Board, and the State Election Commission, must register with the General Services Administration’s “Registro Unico de Licitadores.” After registration, each prospective bidder must obtain a Certificate of Eligibility. All applicable executive agencies and public corporations of the Government of Puerto Rico must use and verify the qualifications of the bidders before awarding bids for the purchase of goods or entering into contracts for any such services.

Also, some Puerto Rico government agencies and instrumentalities might have, by regulation, additional bidders’ filing requirements. It is important to verify the prospect entity before submitting the GSA Certificate of Eligibility to comply with any additional agency requirements.

- 9. **Manufacturer’s Excise Tax Identification Number:** The Excise Tax Act provides tax exemption for raw materials and machinery and equipment used in manufacturing plants. Companies seeking to benefit from such exemption must obtain a Manufacturer’s Excise Tax Identification Number from the Excise Tax Bureau to take raw materials at ports of entry and to prove exemption status.
- 10. **Construction and Use Permit:** Puerto Rico law requires businesses to be located in areas which are zoned for the intended use. Constructing or expanding existing structures to accommodate a business may require a construction permit by the Office of Permits Management or the Municipal Permits Office. Permits are also required before occupying a building and using it as intended. Use permit applications must be



filed with other Commonwealth of Puerto Rico agencies' endorsements or certifications.

#### 11. **Chauffeurs' Insurance Employer Account Number and Notice of Employee Entry:**

Entities must obtain a Chauffeurs' Insurance Employer account number and file notices for employees who drive motor vehicles in the ordinary course of employment before the Chauffeurs' Social Security Bureau of the Department of Labor and Human Resources.

Please note that businesses may be required to obtain additional permits, authorizations, and licenses in accordance with other federal or local laws and regulations which may be applicable to their particular operations. These may pertain to such areas as environmental and natural resources protection, land use, infrastructure, health and safety, building approvals, fire prevention and worker protection, among others.

#### **B. Compulsory Registration of Foreign Entities**

The GCA establishes that foreign corporations may not engage in commerce or conduct business in Puerto Rico without previously receiving an authorization to do business from the Puerto Rico Department of State.

The main penalty imposed by the GCA on unauthorized foreign corporations is a general prohibition to seek redress for damages or commence any legal proceeding at local courts. However, unauthorized foreign corporations may be sued in the local courts and they may defend themselves from any such complaints.

The GCA provides a non-exhaustive list of activities that are not considered "doing business" for purposes of the mandatory registration of foreign corporations discussed above. The following activities are specifically considered "non-constitutive" activities for the purposes of the Corporations Act:

- Initiate, defend, or settle any judicial process.
- Conduct meetings of the Board of Directors or stockholders or other activities related to internal corporate affairs.
- Maintain bank accounts.
- Keep offices or agencies for the transfer, exchange, and registration of the corporation's own securities or keep trustees or depositories with respect to such securities.
- Sell through independent contractors.
- Solicit or obtain orders, whether by mail or by employees or agents or otherwise, if such orders are to be accepted outside of the Commonwealth before a contractual obligation arises.
- Create or acquire debts, mortgages, or personal and real property securities.
- Guaranty or collect debts, or foreclose on mortgages or securities on the properties which guaranty such debts.
- Own title to personal or real property.
- Conduct an isolated transaction which is completed within a period of thirty (30) days and which is not part of a series of similar nature.

The need to register and the exceptions to the registration also apply to limited liabilities companies.

### **3. REGULATION AND ONGOING MAINTENANCE**

#### **A. Reporting Requirements**

**Annual Reports:** All corporations (domestic and foreign) as well as professional corporations must file a yearly annual report with the Puerto Rico Department of State, no later than April 15 of the year. Filing fees for annual reports are



\$150.00 for for-profit corporations and \$5.00 for non-profit corporations.

**Annual Dues:** LLCs only need to pay an annual fee on or before April 15 of each year. The annual fee for the limited liability company is \$150.00.

Failure to submit the Annual Report or pay the Annual Fees entails the imposition of penalties and possibly the cancellation of the legal entity.

**B. Special Regulations and Requirements to Conduct Business**

**Consumer Protection Laws and Regulations:** The Department of Consumer Affairs (“DACO”, for its Spanish acronym) is a governmental consumer advocacy agency which advises consumers regarding their rights. DACO also has enforcement authority and is allowed to impose fines and penalties as provided by law. DACO also restrains inflationary trends and implements and monitors price controls over goods and services. To achieve its objectives, DACO has promulgated a series of regulations covering such different areas of consumer interest and protection such as:

- Misleading practices in advertising
- Contests and sweepstakes
- “Rain checks”
- In-store pricing labels and other required store signage
- Automobile warranties
- Real estate brokerage
- Residential real estate development
- New condominium registrations
- Condominium Law violations
- Construction defects and other construction-related services
- Gasoline retail prices

- Cement quality controls
- Real property contractor registration
- Collection agencies

Almost any complaint that a consumer may have against a retailer, service provider or any other type of business establishment that serves the public can be presented to DACO for review. DACO has the authority to hold administrative hearings and to issue rulings against businesses, and may inspect businesses and establishments in Puerto Rico as part of its standard regulatory enforcement procedures. DACO is also authorized to impose fines, which can currently reach up to \$10,000 per infraction, and may also refer certain violations for criminal action.

It should be noted that all DACO laws and regulations are subject to periodic amendments and changes.

**The Dealer’ and Sales Representatives’ Contracts Acts:** The Dealer's Contract Act, Act 75 of June 24, 1964, as amended (commonly referred to as "Act 75"), is aimed at protecting the interests of dealers or distributors, whether they are exclusive or not, operating in Puerto Rico from the harm caused when a principal or supplier arbitrarily terminates or impairs a distributorship.

An offspring of the Dealer’s Contract Act, the Sales Representatives’ Contract Act, was enacted as Act 21 of December 5, 1990. Act 21 protects only exclusive sales representatives — who normally assume all the operational costs which such representation entails, such as the cost of maintaining an office, exhibition rooms, vehicles, office personnel, phones, power, water, insurance, travel costs, representation costs, office supplies, and municipal patents from termination or impairment without just cause.

Under either Act 75 or Act 21, the contract may



not be terminated, or have its renewal withheld or impaired without just cause. The “established relationship” between the parties is governed by the agreement. Therefore, such laws normally only protect against detriments to contractually acquired rights of the relationship derived from a dealer’s or sales representative’s contract with few exceptions. However, the laws require just cause to impair, terminate or refuse to renew regardless of any contract clause establishing a fixed term or allowing impairment, termination or non-renewal other than for just cause. The term ‘just cause’ is explicitly defined by both laws.

**Bank Activities:** Puerto Rico does not have a central bank and thus forms part of and is regulated by the Federal Reserve System. Local as well as foreign banks (by means of branches or representative offices) must obtain a license from the Commissioner of Financial Institutions before starting operations. The Puerto Rico Office of the Financial Institutions Commissioner controls, supervises and regulates the interest rates and maximum fees applicable to any given financial transaction, unless otherwise specified in special legislation.

**Securities Activities:** The U.S. Securities and Exchange Commission (SEC) controls the purchase and sale of securities in the U.S. markets. For purposes of the SEC, Puerto Rico is considered part of the U.S. market. Since Puerto Rico does not have a local securities exchange market, generally all purchases and sales of securities in Puerto Rico are done in the U.S. markets. In addition, the Commissioner of Financial Institutions regulates financial activities in Puerto Rico at a local level. Therefore, certain public issuances of bonds or preferred stocks, among others, must be registered with the Commissioner of Financial Institutions to be marketed and sold in Puerto Rico.

**Insurance Activities:** The insurance industry is subject to the provisions of the Puerto Rico Insurance Code and the rules and regulations promulgated by the Puerto Rico Office of the Commissioner of Insurance.

**Notary Public:** The notary public in Puerto Rico follows civil law traditions, which are different from the common law notary public. The main difference between a notary public in Puerto Rico and most stateside counterparts is that a notary public in Puerto Rico will always be a licensed attorney (all notaries are licensed attorneys; not all attorneys are notaries). As such, a notary public receives, interprets, and provides legal form to parties’ wills, usually through the execution of a public deed. Public deeds are generally required for the transfer of real estate, effecting powers-of-attorney and executing private wills. The notary also authenticates the identity of a signatory as well as the date of execution of a given document. Both notarial functions must be regularly notified to corresponding registers. By law, most notarial fees are fixed.

**Environmental Matters:** Environmental requirements for businesses establishing operations in Puerto Rico depend on the activities undertaken by the company. Generally, there are federal and Puerto Rico statutory and regulatory requirements requiring that environmental permits be obtained and/or the registration of certain activities. A number of processes and operations subject to medium-specific federal programs, such as the Clean Air Act, Clean Water Act, Resource Conservation and Recovery Act, Toxic Substance Control Act, Oil Pollution Act, and the Emergency Planning and Community Right to Know Act also apply in Puerto Rico. Other federal requirements stem from the Federal Insecticide, Fungicide and Rodenticide Act and the Food and Drug Act, among others. Commercial operations often require the preparation and implementation of





a Recycling Plan, the appropriate permits for the construction and operation of emergency generators, sanitary license, and certificate and permit for fire prevention.

**a. Other considerations**

**a. Free Trade Zone**

Puerto Rico has a very close relationship with the United States while conserving certain fiscal independence. This is particularly evident when discussing Puerto Rico's "free trade zones." A free trade zone offers a business a unique opportunity to establish its operations in an area with lower trade barriers and fewer bureaucratic requirements.

As a rule, imports and exports to and from Puerto Rico are subject to customs and tariff regulations issued by the United States. The Federal Foreign Trade Zone Act allows merchandise to enter and leave free trade zones in Puerto Rico without being subject to the customs laws of the United States. While in a free trade zone, a business may handle the merchandise as provided by the federal statute, and subsequently export it outside the zone with little or no customs impact. This also includes the manufacture of certain goods in the free trade zone.

Many businesses have taken advantage of the Puerto Rico free trade zones, allowing them to move merchandise between free trade zones with no customs impact. This translates into lower operational costs, resulting in increased business revenues.

**b. Labor and Employment**

Puerto Rico is subject to all federal laws unless specifically deemed otherwise due to geographic or public policy considerations. Hence, labor and employment statutes applicable in the 50 U.S. states and the District of Columbia are almost always

applicable and enforced in Puerto Rico. Local statutes enhance or supplement federal employment law, and sometimes offer other protections not provided by federal law. Puerto Rico departs from the employment at will standard in that employees are provided multiple safeguards in terms of the legal and monetary ramifications in cases involving wrongful termination. In particular, the law provides severance pay based on years of employment for employees terminated without just cause.

Some of the U.S. federal laws applicable in Puerto Rico in the labor and employment context are: The Fair Labor Standards Act (FLSA); the Employee Retirement Income Security Act (ERISA); the National Labor Relations Act (NLRA); the Consolidated Omnibus Budget Reconciliation Act (COBRA); the Family and Medical Leave Act (FMLA); the Americans with Disabilities Act (ADA); and the Uniformed Services Employment and Reemployment Rights Act (USERRA); among others.

The following is a summary of the most relevant local labor and employment statutes applicable to workers in Puerto Rico:

**Working Hours:** The maximum working period per day shall not exceed eight hours. Local law provides greater protections than the federal counterpart with respect to the payment of overtime for time worked after eight hours per day and/or for time worked more than 40 hours in the work week.

**Maternity Leave and Benefits:** Local law grants pregnant employees the right to enjoy maternity leave. The rights, protections, and benefits afforded by law apply to pregnant employees that are working, enjoying regular vacation or on sick



leave, or are under any other type of special leave or rest authorized by law while the employment relationship is in effect. During pregnancy, working women are entitled to a fully paid rest period of four weeks before childbirth and four weeks after childbirth. In Puerto Rico, it is illegal to dismiss, lay-off, reduce the salary, or discriminate in any manner against a female worker due to a reduction in her work productivity while she is pregnant. The employee is entitled by law to reinstatement and double damages for any violation.

**Christmas Bonus:** As of January 27, 2017, Employers that employ 20 or more workers within the 12-month period comprised from October 1 of any calendar year until September 30 of the subsequent calendar year must pay each employee that has worked 1350 or more hours during said period, an annual Christmas bonus. Special provisions apply to employers with less than 20 employees and/or those who are experiencing economic hardship.

**Discharges:** The general rule in Puerto Rico is that any employee in commerce, industry or any other business that has been hired without a fixed term of employment can be discharged for just cause, without cause, or even for an unjust cause. However, Commonwealth of Puerto Rico law provides for a mandatory severance payment to any employee hired without a fixed term who is discharged from his employment without just cause or for an unjust cause. A breach of contract action may be brought by any employee hired for a fixed term.

It is therefore indispensable that reasonable written work rules of discipline and performance be published by the employer, and a copy of such rules is given to the employees for a discharge made pursuant to

such rules to be considered as one for “just cause” within the meaning of the law.

**Discrimination:** Payment of substantial compensation may be imposed upon employers that are found to engage in the following activities: the discharge, lay-off or discrimination against an employee regarding his/her salary, wage, pay or remuneration, terms, rank, working conditions, or work privileges; or, failing or refusing to hire or rehire a person, or limiting or classifying its employees in any manner which tends to deprive a person of employment opportunities, or to affect her/his status as an employee, on the basis of age, race, color, gender, sexual orientation, status as a victim of domestic abuse, social or national origin, social position, marital status, political or religious beliefs of the employee or applicant for employment.

**Sexual Harassment:** Puerto Rico law prohibits sexual harassment in the workplace towards any employee and imposes severe monetary liability on any person or employer responsible of sexual harassment as defined in the law.

**Discrimination against the Disabled:** The Commonwealth of Puerto Rico also prohibits discrimination by government contractors and employers with 15 or more employees against individuals with disabilities. Employers must make reasonable accommodation for the limitations of disabled individuals, unless said accommodation constitutes “an undue hardship in economic terms to the enterprise.”

**Veterans:** Puerto Ricans can voluntarily serve in all branches of the U.S. armed forces. Puerto Rico law imposes upon the employer the obligation to reinstate a



veteran to his former job, provided he petitions for it within a period of six months after his dismissal or discharge from the armed forces.

**Minimum Wage:** The Federal minimum wage, which is currently \$7.25 p/h, applies to employers that are subject to the FLSA.

**Labor Transformation and Flexibility Act:** The Labor Transformation and Flexibility Act (LTFA) of January 2017 substantially amended Puerto Rico employment laws, modified employment agreements and change compensation and benefits to create a more competitive employment environment. Some of these changes include a reduction in vacation and sick leave accrual rate for new employees; increase in working requirements to accrue employment benefits; automatic and substantial increase to probationary periods; reduction in overtime rate; reduced mandatory Christmas bonus; reduction in statute of limitations and civil liability exposure for employers, among others.

#### c. Immigration Overview

Puerto Rico is subject to the U.S. Immigration and Nationality Act, as amended (INA), and Puerto Ricans are U.S. citizens by birth. Unlike other federal statutes, there are no exceptions with respect to Puerto Rico in the INA. Therefore, only the following individuals may legally engage in employment in Puerto Rico: (1) citizens of the United States of America; (2) legal permanent residents; and (3) temporary foreign workers specifically authorized by the U.S. Department of Homeland Security through its U.S. Citizenship and Immigration Services and the Department of State through the National Visa Center.

The employment of foreign specialized professionals, including mid- and high-level managers and executives is usually allowed by the federal government. Recruitment of unskilled and skilled labor, as well as first-line supervisors is usually more difficult. A special arrangement exists for individuals of the following countries: Canada, Mexico, Chile, Australia, and Singapore.

#### d. Tax Overview

In general, Puerto Rico residents and corporations organized under the laws of Puerto Rico (“PR Domestic Corporations”) are subject to Puerto Rico income tax on all their income from whatever sources derived. Furthermore, since PR Domestic Corporations are considered “foreign corporations” under the U.S. Internal Revenue Code, they are, in general, only subject to U.S. taxation to the extent that they derive any U.S. source income.

Similarly, foreign corporations engaged in trade or commerce in Puerto Rico (“Resident Foreign Corporations”) are also subject to Puerto Rico taxes, but limited to their Puerto Rico source income and its income effectively connected with the conduct of a trade or business within Puerto Rico. Furthermore, a Resident Foreign Corporation deriving less than 80% of its gross income from Puerto Rico will be subject to the Branch Profit Tax (BPT). The BPT is imposed on foreign entities doing business in Puerto Rico at a rate of 10% on accumulated profits treated under the law as a dividend or profits equivalent amount.

#### 1. Income Taxation

Currently, there are two types of corporate income tax imposed under the Puerto Rico Internal Revenue Code of 2011, as amended (“PR Code”):



- a regular corporate tax, which is imposed on the net taxable income of the corporation or LLC that is taxed as a corporation; and
- an alternative minimum tax (AMT), which is imposed on the alternative minimum net income (AMNI) of the corporation.

The corporation’s net taxable income is generally imposed on its gross income less the deductions allowed under the PR Code. Such net taxable income is subject to a normal tax of 20% plus a surtax that ranges from 5% to 19% on its surtax net income.

## 2. Alternative Minimum Tax

### i. In General

In addition to the regular tax, corporations may be subject to the AMT. The AMT due in such cases would be the excess, if any, of the tentative minimum tax over the regular tax. Currently, the tentative minimum tax is composed of:

- 30% of the AMNI over the “exemption amount,” reduced by the AMT foreign tax credit for the taxable year.

For purposes of AMT, the AMNI is computed in the same manner applicable in the computation of the regular tax, except for certain adjustments.

## 3. Municipal License Tax (“Patente”)

Every person, natural or legal, engaged for profit in the rendering of any service, in the sale of goods, in any financial business or in any industry or business in Puerto Rico is subject, with limited exceptions, to the payment of the Municipal License Tax. This municipal tax is imposed on the taxpayer’s

gross income.

The Municipal License Tax imposed on persons engaged in the rendering of a service, the sale of goods, or any other industry or business (other than a financial business) may not exceed 5/10 of 1% (0.5%) of the volume of business realized by that person in the corresponding municipality. Volume of business, for this purpose, means the gross income received or earned in the municipality where the main organization carries out its operations or the gross income received or earned where it maintains offices, warehouses, branches, or otherwise conducts business. Accordingly, the tax must be paid to the municipality where the main organization is located, unless the gross income is received or earned in a different municipality through offices, branches, warehouses or any other commercial organization in that municipality.

## 4. Personal property taxes

### i. In General

All tangible personal property, owned by an individual or a legal entity and used in a trade or business, having taxable situs in Puerto Rico is taxable unless specifically exempt. “Personal property” or “movable property” includes essentially all things other than real estate that have any pecuniary value. Such property is assessed as of its status and condition on the first day of January of each year. In other words, taxpayers are subject to the personal property tax on all property it owns as of the first day of January of each year, except for inventory as discussed below.

With respect to personal property, every person must file a personal property tax return that requires that person to value



the property, and assess and pay the tax, based on the book value of the property. Book value, for these purposes, is the acquisition or production cost of the asset, adjusted for depreciation, obsolescence or other factors as reflected in the books of the company in accordance with generally accepted accounting principles. When the book value is minimal, however, the assessed value is the estimated residual value of the property as defined by law. Residual value is a percentage of the actual cost of the property, which percentage ranges from 10% to 20%, depending on the remaining life of the asset.

#### **ii. Inventories**

A principal exception to the use of January 1 as the valuation date for property tax assessment is the valuation of inventory. Inventory is valued and assessed based on the annual average inventory value during the calendar year immediately preceding the January 1 assessment date. For appraisal purposes, the inventory appraisal method known as “LIFO” (last-in/first-out) is not an acceptable accounting method.

#### **iii. Personal Property Tax Rates for Municipalities**

Personal property tax rates are generally 2.00% less than the corresponding real property tax rate for each municipality. The personal property tax rates vary from municipality to municipality. For fiscal year 2016-2017, the personal property tax rates range from as low as 5.80% to as high as 9.83%.

#### **e. Tax Incentives**

Puerto Rico offers attractive tax incentives to businesses wishing to establish

operations in the Island. The Economic Incentives Act for the Development of Puerto Rico (“Tax Incentives Act of 2008”) continues the historical line of local government incentives for investment in Puerto Rico. The Tax Incentives Act of 2008 reduces the income tax rates for eligible businesses to 4% (in some cases to 0% income tax). No tax is imposed on corporate distributions to shareholders. Exempt businesses also receive substantial tax exemption for other local taxes, such as a 90% exemption on property taxes and a 60% exemption on local municipal taxes. Other tax incentives acts, such as the Green Energy Incentives Act of Puerto Rico and the Puerto Rico Tourism Development Act, also provide similar tax benefits. Furthermore, tax incentives are also available for the operation of hospitals and bona fide agricultural businesses within Puerto Rico.

In addition to reduced rates, exempt businesses may qualify for substantial tax credits on certain investments. Many of these credits may be sold to third parties. These tax credits apply to eligible investments made in energy efficiency, strategic construction projects, tourism projects, acquisition of machinery and equipment, and research and development, among others.

#### **f. Special Tax Incentives to companies and individuals relocating to Puerto Rico – Acts 20 and 22**

Act to Promote the Export of Services, Act No. 20 of January 17, 2012, as amended (Act 20), also offers tax incentives for the export of services from Puerto Rico. Puerto Rico’s geographic location and bilingual workforce, coupled with lower tax rates for businesses that export services, make the Island particularly attractive for businesses looking





to set up headquarters for the eventual export of services to other markets in Latin America and the rest of the world. Tax benefits under Act 20-2012 are like those granted under the Tax Incentives Act of 2008: (1) 4% flat income tax rate; (2) 0% tax on distributions to shareholders; (3) 90% exemption on property taxes; and (4) 60% exemption on municipal taxes.

Finally, the Act to Promote the Relocation of Individual Investors to Puerto Rico, Act No. 22 of January 17, 2012, as amended (Act 22), looks to promote the relocation of investors that are non-residents of Puerto Rico by providing Puerto Rico income tax exemption on all passive income earned or accrued after becoming Puerto Rico bona fide residents, as well as capital gains in certain cases. Pursuant to Act 22, interest and dividend income from all sources that is earned by the individual after becoming a Puerto Rico resident is exempt from Puerto Rico income taxes (including the alternative minimum tax).

In the case of capital gains, during the first 10 years of residency in Puerto Rico, Act 22

states that the income tax rate applicable for the tax year in which the gain is realized will apply on long-term capital gains accrued and unrealized that are attributable to the increase in value of the securities before the individual becomes a Puerto Rico resident. However, after said 10-year period, a reduced 5% income tax rate will apply to such long-term capital gains that are recognized before January 1, 2036.

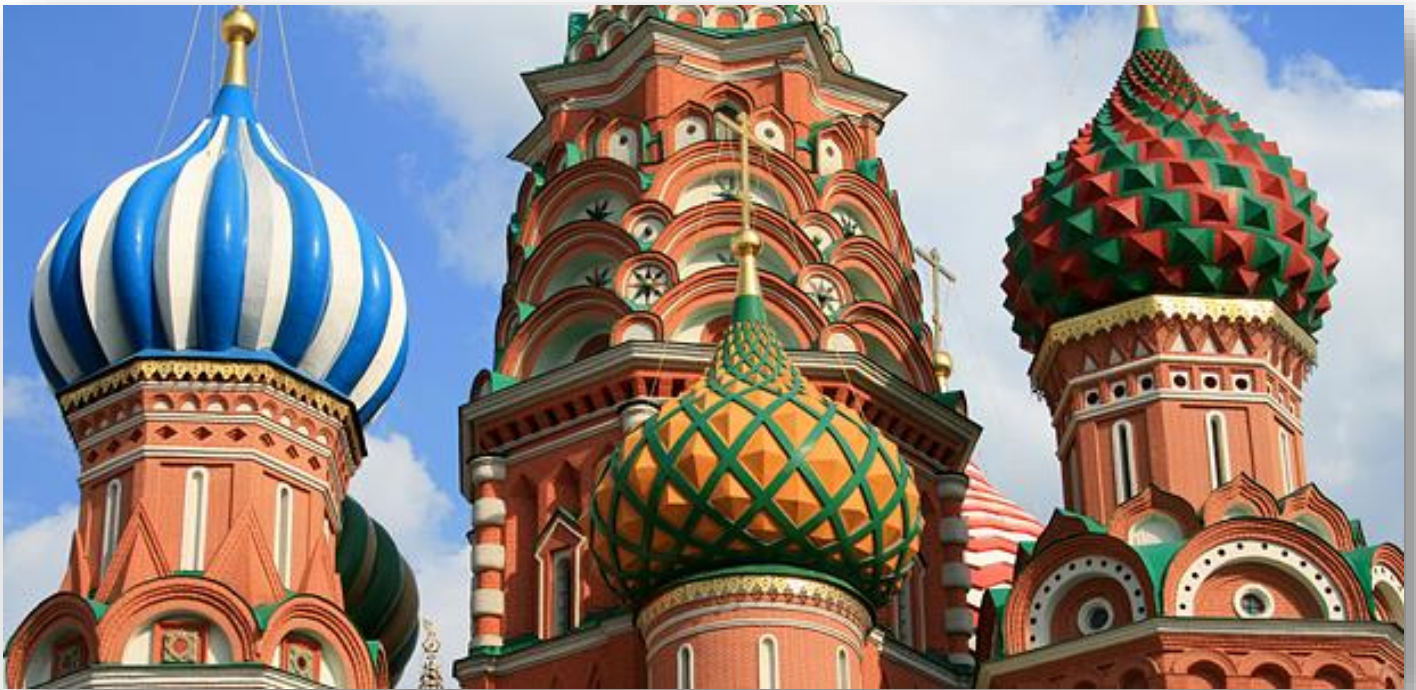
On the other hand, Act 22 states that both short and long-term capital gains accrued after the individual becomes a Puerto Rico resident and that are recognized before January 1, 2036, will be fully exempt from Puerto Rico income taxes. In the case of securities acquired by the individual before becoming a Puerto Rico resident, the total exemption applies only to the extent that the short or long-term capital gain is attributable to the increase in value of the securities after the individual becomes a Puerto Rico resident.



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# INTERNATIONAL LAWYERS NETWORK



LIDINGS LAW FIRM  
ESTABLISHING A BUSINESS ENTITY IN RUSSIA



## ESTABLISHING A BUSINESS ENTITY IN RUSSIA

Russia is the largest country in the world in terms of size, having a vast territory of 17.1 million square kilometers. It shares borders with many European and Asian countries such as Norway, Finland, Estonia, Latvia, Lithuania, Poland, Belorussia, Ukraine, Georgia, Azerbaijan, Kazakhstan, China, and Mongolia (plus sea borders with the United States and Japan). Its population in the beginning of 2010 numbered 141.9 million people.

Russia is a federal republic comprised of 85 constituent entities. There are six categories of federal constituent entities that represent equal members of the federation. They include 22 republics, 46 regions, one autonomous region, 9 territories (krajs), 4 autonomous okrugs and three cities of federal significance: Moscow, St. Petersburg, and Sevastopol.

The 8 years of Vladimir Putin’s presidency from 2000 to 2008 was a period of rapid economic growth incurred by an increase in commodity prices and accompanied by a significant increase in living standards. The introduction of consumer loans and mortgages fueled local consumption. The country was exposed to the crisis that started in the final quarter of 2008, as national Gross Domestic Product decreased to 7.8% for 2009, however by the year 2013 several Russian areas had mostly returned to pre-crisis levels.

Despite foreign investments falling in 2009 by 21 percent to USD 81.9 billion, already the beginning of 2010 resulted in an economic revival which led to further growth and development in various industries.

The Russian government focuses on the creation of a modern, innovative economy. The current trend in Russian government activity is making the country and its economy more attractive to foreign investors and less dependent on the country’s huge, but exhaustible resources. Within the last several years Russia has become a large

presence in the global economy.



Russian law is a civil law system. Therefore, the main regulations in business and economic relations are contained in different legislative acts, adopted mainly at the federal level by the Parliament (“State Duma”), and subordinate acts issued by various governmental authorities and institutions. Legislative power is exercised by a bicameral Federal Assembly, which consists of the Federation Council (upper house) and the State Duma (lower house).

### 1. Types of Business Entities

Foreign investors may conduct business activities in the territory of Russia using one of the forms of legal entities stipulated by the law.

The law establishes an exhaustive list of forms for commercial entities. It includes partnerships (general partnerships and limited partnerships), companies (limited liability companies, public joint-stock companies, and joint-stock companies (non-public), as well as peasant (farm) enterprises producers’ cooperatives, business partnerships and state and municipal unitary enterprises. State and municipal unitary enterprises are commercial organizations in which the ownership of assets does not pass to the organization itself. The assets of a state-owned or municipal enterprise are under government or municipal ownership;



the enterprise has the rights of administrative management or operational control. Only state-owned and municipal enterprises can be set up in the form of unitary enterprises. The unitary enterprise is managed by its director, who is appointed by the owner (i.e., state or municipal authority) or the body authorized by the owner, and is accountable to them. In the late 1990s, the government decided to end this form of organization. However, many of these enterprises still exist.

Most common forms of business entities that are used by foreign investors in their commercial activities in Russia as well as a description of the steps for their establishment and registration are set out below.

### **1.1 A description of the types of entities available for conducting business**

#### **Limited Liability Company**

A limited liability company (“obshestvo s ogranichennoy otvetstvennostyu” or “OOO” in Russian) (the “LLC”) is the most widely used form of business entity according to official state statistics. It is a non-public company. An LLC is allowed to engage in most business activities. The charter capital of an LLC is divided into shares (participatory interests) that are not actually recognized as securities. Generally, a participant’s liability is limited to the amount of his investment in the charter capital, i.e. to his participatory interest. The LLC is regarded as a simplified business entity and the least burdensome, as the rules governing an LLC’s internal corporate relations are mostly of flexible nature. An LLC may have no more than 50 participants and LLCs with sole participants are not prohibited<sup>37</sup>.

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<sup>37</sup> Unless the sole participant of LLC is a legal entity having only one participant, which is in general prohibited under art. 66 of the Civil Code

The minimum charter capital of an LLC amounts to RUB 10,000 (approx. 170 USD) and is divided into participatory interests. There is no requirement as to the minimum size of each participant’s contribution but the Charter of the LLC may provide for one member’s maximum participatory interest. Participatory interests may be paid in various forms including cash, securities, assets, and rights. The forms of contribution to the charter capital can be limited if provided for in the Charter. The Charter or corporate agreement of an LLC may provide for a non-proportionate distribution of members’ rights to their shares provided that this information is included in the unified state registry of legal entities (EGRUL).

Specific legislation can stipulate larger amounts of charter capital depending on the business activities which will be exercised by the LLC (or any other legal entity). For example, to obtain a license for the retail of spirits and wines (except beer) depending on the region of the Russian Federation, the LLC could be obliged by regional state authorities to have charter capital of no less than RUB 1,000,000 (approx. 17,000 USD).

The charter capital of the LLC is payable within four months from LLC incorporation date. Once the charter capital is paid in full it may be increased or decreased by resolution at a general participants’ meeting. An increase of the charter capital may be implemented on the account of the company’s assets, the secondary investments of participants or the contribution of third parties admitted to the LLC. Charter capital decrease requires the notification of all creditors of the LLC.

#### **Joint-Stock Companies**

A joint stock company (a “JSC”) (“aktsionerное obshestvo” in Russian) is a commercial corporate entity entitled to carry out most business activities. Unlike an LLC, the charter capital of a JSC is divided into shares recognized as securities.





Thus, a wide range of rules related to capital markets and securities applies to JSCs. Moreover, corporate legislation applicable to JSCs appears to be more imperative and precise.

In accordance with the Federal Law No. 99-FZ dated 05 May 2014 “On amending chapter 4 of part one of the Civil code of the Russian Federation and on recognizing inoperative separate provisions of the legislative acts of the Russian Federation” which introduced significant amendments to the current civil legislation there are two types of JSC:

- public joint stock company (PJSC) in case (a) it performs public placement of shares (bonds) or (b) said shares (bonds) are publicly listed or (c) its Charter and name refer to its public status;
- non-public joint stock company, named “joint-stock company” (NJSC) if it doesn’t meet abovementioned criteria of the PJSC.

The PJSC and NJSC differ in charter capital amount requirements, requirements on the number of shareholders, public placing limitations issues, the preferential rights of shareholders, and requirements on information disclosure. A PJSC may have an unlimited number of shareholders. Shareholders in a PJSC are entitled to freely alienate their shares. The number of shareholders in a NJSC should not exceed fifty, otherwise it must be transformed into a PJSC, and the shareholders of a NJSC may benefit from preferential rights on alienated shares.

The minimum authorized capital for an PJSC is RUB 100,000 (approx. 1 700 USD), whereas the minimum authorized capital for a NJSC is RUB 10,000 (approx. 170 USD). Both PJSCs and NJSCs are entitled to issue ordinary and preference (no more than 25%) shares. Shares of a particular type should be of equal nominal value. NJSC shares are not subject to public placement and circulation, but both PJSCs and NJSCs are entitled to issue bonds. Issuance of any securities, as well

as their consolidation, conversion, or division, require certain corporate approvals, in most cases – by an extraordinary resolution at a general meeting. At the same time, all such procedures are subject to capital market regulations.

Ordinary shares grant the shareholder the same corporate rights as a participant in an LLC: management (voting) rights, the right to obtain information about the corporation’s activities, and the right to receive the declared dividend and liquidation quota. Preference shares, generally, are “non-voting” but may become voting in certain cases specified by law.

The number of a shareholder’s votes is proportional to his stake, reflected in the register of shareholders containing information about each registered shareholder including the number, category, and classes of shares held. The Charter or corporate agreement of NJSC may provide for a non-proportionate distribution of members’ rights to their shares provided that this information is included in the unified state registry of legal entities (EGRUL). Like participants in an LLC, shareholders in a NJSC possess a pre-emptive right to purchase shares sold to third parties at the same price. Shareholders in both types of JSC have a pre-emptive right to purchase newly publicly issued shares pro rata to their existing stakes.

### **Partnership**

Partnerships (“tovarishество” in Russian) are considered less formal business entities, and are actually less widespread. A partnership means: joint ownership, joint management, and joint profits. The Civil Code distinguishes between Full (“polnoye” in Russian) and Limited (“tovarishество na vere” in Russian) partnerships. A limited partnership may have two types of members: partners (full partners) and contributors (limited partners). The number of limited partners must be no more than 20 people, otherwise it must be transformed into a company





within one year (if not, it is subject to liquidation upon court's decision). Full partners are fully liable for their partnership obligations. Limited partners bear liability the same way as LLC participants do (i.e. limited by their share in the capital), but are not entitled to participate in management. Only commercial entities and sole proprietors may act as full partners, while there are no such limitations for limited partners. In addition, full partners may participate only in one partnership as full partners.

In Russia, a partnership should create a pooled (joint) capital, which consists of all tangible and intangible property contributed by partners (and by limited partners if applicable). There is no requirement on the minimum amount of pooled capital. Profits and losses are distributed among the partners pro rata their interests in the pooled capital. Both full and limited partnerships are not entitled to issue any securities.

The ownership stakes of all partners are equal, unless agreed otherwise in the Foundation Agreement. If a partner drops out of the partnership, he should be given the monetary or property equivalent of the current value of his interest. For the alienation of a share in partnership to third parties or another partner, the consent of all other partners should be obtained.

### **Business Partnership**

A business partnership ("hozyaistvennoye partnerstvo" in Russian) is a form of business entity, which was introduced by the Federal Law "On business partnerships" that became effective starting from the 1<sup>st</sup> of July 2012. This form must be distinguished from the above described forms of full and limited partnerships. From the legislative standpoint, business partnerships are intended to operate as an SPV during innovative activities (including venture activities). A business partnership is determined by the law as a commercial organization created by one or more

persons that is managed by the participants of the partnership or other persons. A business partnership has limited capability in the sense that it is not allowed to establish other legal entities (except non-profit unions and associations). Neither can a business partnership issue obligations or other equity securities. Russian Law defines the formation of pooled capital in business partnerships by analogy with full and limited partnerships. Contributions to the pooled capital can be assets, monetary funds, proprietary rights and other rights having monetary value. However, securities may not be contributed to its capital, except for bonds issued by certain companies included in a special list maintained by the Bank of Russia.

There are no minimum pooled capital requirements for business partnerships.

Partners' interests should be defined in the register of the business partnership. Partners' interests in the pooled capital may be subject to transactions. The procedure of concluding such transactions is mostly determined by Management Agreement. Partners enjoy preemptive rights to purchase other partner's interest (this rule may be rescinded by Management Agreement).

### **Representative Offices and Branches**

Foreign companies are able to start a business in Russia through a branch ("filial" in Russian) or a representative office ("predstavitelstvo" in Russian). According to the Civil Code, both branches and representative offices are not acknowledged as legal entities, but recognized only as subdivisions of their head company (including foreign companies) ("subdivisions"), which are located in a place other than the head company's office. The activities of representative offices and branches are maintained by the head company, which is to provide assets and to be fully liable as well.



These two kinds of subdivisions differ in the functions they are supposed to implement. A representative office is entitled only to represent and to protect the interests of the head company and is supposed to be engaged in non-commercial activities. A branch, in turn, is entitled to perform any of the head company's functions, including but not limited to representative office functions, on behalf of the head company. In particular, a branch is generally taken to be engaged in commercial activities with subsequent deprivation of profit.

### **1.2 Matters to be considered when choosing a particular business entity type**

An investor should answer the following questions when deciding which legal structure to employ in his or her business:

1. Constitutive aims (to make profit or engage in socially oriented activities)
2. Plans of business development (to form a public company and attract investors, or run an independent company and not borrow any funds)
3. Business holders' rights (their participation in management, their level of involvement in business development)
4. Confidentiality of business
5. Level of defense against corporate attacks
6. Tax planning
7. Starting expenditures

There are no strict advantages or privileges to any form of business organization. Tax planning is performed individually depending on entrepreneurial business and other factors.

The choice of business legal structure depends on the goals of its incorporators. The LLC is, apparently, the simplest model both in terms of its incorporation procedure and its further functioning (there is no requirement to register

the issuance of shares; therefore, the founders don't incur costs related to this). The participants can also remain in effective control by using, in particular, their preferential right to acquire transferred interest in the authorized capital. A NJSC has lots of similarities with an LLC, and the main difference is in the composition of the charter capital: shares as securities in a NJSC compared to participatory interests in an LLC. A NJSC provides a substantially higher level of confidentiality, but corporate risks are also higher. A PJSC is a form of public organization—its main purpose is to attract investment. It requires large material and organizational expenditures and assumes more complicated mechanisms of company management and decision-making by regulatory bodies. If the founder cannot decide whether the company will be public at its establishment, but doesn't wish to lose such a possibility later, it is better to choose a NJSC as opposed to an LLC, as the procedure for changing the business legal structure from a NJSC to a PJSC is simpler.

Legal entities may use standard charters adopted by the authorized body. Information on use of standard charter shall be included into EGRUL based on special application which shall be filed with the registering authorities.

If the company's aims change, it is possible to hold a reorganization (for tax optimization, increased transparency, as well as its capitalization): to form a holding company, to enlarge or diminish separate companies, to render merger and acquisition transactions, etc.

If the purposes of establishing a legal presence in Russia are rather limited, it might be reasonable to consider opening a representative office that will perform only general marketing tasks. Despite its accreditation procedure being rather time consuming and substantially more expensive than the incorporation of an LLC, in the long term the representative office will enjoy the



advantages of less administrative formality and bureaucracy when receiving work permits for its foreign employees, easier funding procedures, and even some tax exemptions. Having similar benefits, a branch could also be a convenient and suitable option for foreign investors who plan to start certain real business activities (e.g., production, maintaining warehouses, rendering services, etc.) right away. However, it should be considered that both forms are less flexible for further extension of foreign business in Russia and are limited in some business opportunities that are available to local legal entities.

In any case, while starting up a business and later while running it, it is essential to strictly follow all procedures as stipulated in the legislation. This will not only prevent claims from state authorities, but will also increase the company's capitalization and ease further business operations and development.

The next section will divulge in more detail the main steps required to establish certain forms of legal entities in the territory of Russia.

## **2. Steps and Time required for Establishment**

### **Limited Liability Companies**

An LLC may be established at foundation or through the reorganization of a currently existing entity. An LLC is established based on a Foundation Agreement and the Resolution of a foundation meeting (or the Resolution of the sole founder), but, as with all other legal entities, is considered incorporated from the date of its state registration. The procedure of LLC establishment usually takes from two to four weeks and includes registration with the tax authorities and with non-budgetary pension and insurance funds and statistics authorities, the creation of a seal, the opening of bank accounts, the appointment of a General Director and some other internal corporate actions. LLC registration does not require any securities issuance procedures, but

participatory interests should be paid within 4 months after the time of state registration. At the moment of registration, no participatory interests need to be paid.

### **LLC incorporation procedure**

In compliance with the provisions of the Law on registration, the incorporation procedure for legal entities is comprised of the following steps. The first step consists of the preparation of a full set of incorporation documents to be submitted to the registering authorities, i.e. Russian Tax authorities. LLC incorporation documents consist of an application for LLC incorporation with the duly verified signature of the applicant, the resolution on establishment, the LLC's future Charter, a stamp duty payment notice, and a certificate of charter capital payment. The legal address of the future LLC shall be proved by a warranty letter from the lessor and its ownership certificate for the rented premises. LLC as well other legal entities can exercise their business activities based on a model charter adopted by the authorized body. The fact that LLC acts pursuant to a model Charter is entered into unified state registry of legal entities (EGRUL).

For a non-resident applicant, incorporation documents include a notarized translation of the non-resident applicant's passport (unless the documents are lodged by an authorized person acting pursuant to Power of Attorney). A notarized translation of the apostilled extract from the Trade register of foreign companies acting as participant(s) in the future legal entity is also required under the law.

The presence of the shareholder's appointed official (i.e., acting by virtue of bylaws and not power of attorney) in Russia is recommended at the time of filing for state registration. If that is not possible, the applications may be signed abroad, apostilled, translated, and then filed by post, though that will significantly increase the



duration of the process.

Upon the submission of the full set of LLC incorporation documents to the Tax authorities, the registration of the legal entity in Russia takes three working days starting from the date of the documents' submission to the Russian Tax Authorities. The legal entity's incorporation documents can be collected from the Tax authorities by an authorized person acting pursuant to Power of Attorney. The second step consists of the registration of the newly established legal entity with the Statistics authorities and non-budgetary funds. Said procedure includes submitting certified copies of the legal entity's incorporation documents to Mosgorstat and the Pension and Social insurance funds and obtaining confirmation of the registration. This step usually takes no more than 1-2 working days from incorporation. The third step consists of opening an operating bank account.

Opening the operating account takes around 3-5 working days upon the submission of the full set of documents on the newly established legal entity depending on the bank's requirements. Participatory interests in monetary form may then be paid on the operating account of the company (within 4 months since the moment of LLC's registration).

Since 01 May 2014 requirement on notifying the pension fund and social insurance fund on opening operating account has been abolished.

### **Joint Stock Company**

The establishment and state registration of a JSC is not significantly different from that of an LLC. Nonetheless, the establishment of a JSC is closely connected with stock issuance procedures aimed at constituting the charter capital. At the moment of state registration, a JSC is not required to have it paid in at all, but the placement of stock should be implemented at the stage of JSC incorporation.

Stocks placed at the incorporation shall be paid in full within a year since JSC incorporation date. At the same time, not less than 50% of mentioned stocks shall be paid within three months as of JSC incorporation date.

Individuals and legal entities may be the founders of a JSC. A company's foundation document, i.e., its charter, must include information on the company's name, location, the size of its charter capital, the quantity, nominal value, and categories of its shares as well as the classes of preferred shares issued by the JSC. It should be noted that location of JSC as well as other of other entity is determined by indicating the name of federal constituent entity (for instance city of Moscow) where the legal entity is registered.

### **Partnership**

The constitutive document of a partnership is the Foundation Agreement, which should contain detailed clauses on the amount of pooled capital, on the partners' shares and the order of their change, etc. The registration process is like that of an LLC as described above.

### **Business Partnership**

Procedures of establishment, reorganization, and liquidation applicable to business partnerships are simplified. The establishment of a business partnership is implemented by at least 2 and no more than 50 persons (either individuals or legal entities) by the decision of a partners' (founders') meeting, which should, at the same time, adopt a Charter. The establishment of a business partnership through the reorganization of an existing legal entity (or entities) is restricted. The statutory document of a business partnership is the Articles of Association. A business partnership is governed in compliance with a partnership management agreement entered into by the partners in front of notary. This agreement is verified and kept by the notary.

The registration process is also similar to that of



an LLC as described above.

### Establishment of RO and Branch

Both subdivisions should be founded and terminated on the basis of the head company's charter and the provisions of a special local act. In accordance with Russian legislation a representative office and branch of a foreign legal entity in Russia may be opened without any special restrictions. For confirmation of the official status of the representative office or branch it is necessary to undergo an accreditation procedure with the Federal Tax Service of the Russian Federation (FTS)<sup>38</sup>.

Hence, the opening of branches and representative offices consists of several stages, specifically: the accreditation of a branch or representative office with the FTS, and the registration of a branch or representative office with the tax authority within 30 calendar days of the date of the commencement of its activities in the Russian Federation.

Within the period of 12 months since adopting decision on opening representative office or branch the foreign company shall file an application with FTS for accreditation. The accreditation of a representative office is issued by a registration body for unlimited period till ceasing of activities performed by representative office or branch pursuant to respective decision of the head company.

Starting from 01 January 2015 the accreditation procedure changed due to enactment of the Federal law dated 5 May 2014 N 106-FZ "On introduction of amendments to the particular legal acts of the Russian Federation":

-application on accreditation shall include certain documents enclosed to it (the list of the

documents will be adopted by the authorities), as well as certified by the Chamber of Commerce and Industry of the Russian Federation (CCI) data on the number of foreign employees of a branch or representative office;

-term for deciding on accreditation by the FTS is 25 business days;

-document on introduction of entry to the Register constitutes a proper confirmation of accreditation;

-accreditation denial is possible not only in case of inconsistencies in the submitted documents or violation of the term for their delivery, but also for the reason of contravention of branch or representative office opening purposes to the legislation, as well as in case such purposes threaten the sovereignty, political independence, territorial integrity, national interests of the Russian Federation;

-registration of changes to the Register is performed within 10 working days from the day of delivery of proper documents to the FTS.

The management of the RO or branch is carried out based on decisions taken by the foreign company. The latter is entitled to adopt Regulations for the RO or branch that are registered with the applicable authorities (FTS).

The RO of a foreign legal entity consists of the Head of the RO acting pursuant to Power of Attorney issued in his favor by the foreign entity.

In accordance with provisions of the Civil Code of the Russian Federation, the RO is not a legal entity, it does not conduct commercial activity on the territory of the Russian Federation nor derives profit. Thus, it does not have its own funds for disposal. The RO performs representative functions and protects the interests of the foreign legal entity.

There are no requirements as to the formation of charter capital or initial funds for an RO or branch.

<sup>38</sup> Starting from 01 January of 2015 accreditation of branches and representative offices of foreign companies is exercised by Federal Tax Service of the Russian Federation.





RO foreign employees will have to undergo a procedure of personal accreditation with the Chamber of Commerce and Industry of the Russian Federation and obtain a personal accreditation certificate. Personal accreditation of RO employees is performed within the overall number of employees indicated in the register of accredited branches and representative offices.

Apart from the above, in the case of employing non-residents general requirements of Russian labor legislation should be complied with, i.e., registration with State migration authorities, and obtaining invitations and work permits. The statement below is a general overview of the organization of management bodies in the above listed legal entity types including the specifics of their functioning.

### **3. Governance, Regulation, and Ongoing Maintenance**

#### **3.1 Governance and Management**

##### **Limited Liability Company**

All participants of an LLC are granted certain mandatory corporate rights, the number of which depends on the participatory interest amount, and additional rights provided in the Charter or the Shareholder's Agreement. The number of LLC (and all NJSC) participants' corporate rights may be defined not only depending on the participatory interest amount, but also according to other rules, if provided by the LLC's (or any other NJSC's) Charter or by the corporate agreement in case this information is included in the Unified state registry of legal entities (EGRUL).

The participants are entitled to participate and vote in the general meeting, which is considered the supreme governing body of the LLC. Its exceptional jurisdiction includes resolutions on various issues, namely: amending the Charter, increasing the charter capital, forming (appointing) other corporate

bodies, approving annual reports, issuing bonds, reorganization or liquidation, etc. The Charter of an LLC (as well as NJSC) may provide for the extension of competence of the general meeting and a special order of its convening, preparation and holding may be established. Some issues require the unanimous resolution of all participants, but ordinary issues require simple majority of votes, unless otherwise set in the Charter. In an LLC consisting of a sole participant, issues within the jurisdiction of the general meeting are adopted by resolution of the sole participant. According to the Law "On Limited Liability Companies" a distinction is made between ordinary and extra-ordinary general meetings; the former should be conducted at least once a year; the latter may be convened by the general director at any time.

Decisions passed by the general meeting and list of participants who attended the meeting shall be confirmed by notary unless the Charter provides for other way of affirming these facts.

Russian law contains certain provisions for protecting minority shareholders' rights and interests. Shareholders' rights including the right of control, property rights, and the right to information allows minority shareholders to avoid various forms of abuse. The most important property rights for minority shareholders are the pre-emptive right to purchase shares in the legal entity (in Russian law this pre-emptive right is applied if in the LLC a participant is willing to sell their shares to a third party); the right to re-buy their shares in certain cases (as in the reorganization of the company or the acquisition of shares from minority shareholders at squeeze out); and the right to dispute certain transactions of the company in arbitration courts for the benefit of the company. Moreover, the main relief in the case of a violation of property rights is claiming



for damages.

An LLC is not required to create a board of directors (supervisory board) (the “BoD”), but this also may be established by the Charter. The existence of a BoD is considered mandatory as an exception in cases of an LLC bonds listing. The functions and jurisdiction of the BoD are completely determined by the Charter.

The statutory body of the LLC, empowered to act on behalf of the company in all affairs, is the sole executive body which is generally represented by a general director (analogous to the “CEO”) or a Managing company acting under special agreement with the company. The Charter may limit the powers of the sole executive body in its relations with third parties. Some transactions (Major transactions, interested party transactions and others if stipulated by the Charter) require the additional corporate approval of a general participant’s meeting or of the Board of Directors. Generally, an LLC is not required to form a collective executive body, however the Charter may stipulate its formation and powers.

The day-to-day management of the LLC is the responsibility of the sole executive body, which may comprise one person, several persons acting simultaneously, or several sole executive bodies acting independently, or may consist of both a sole executive body and a management committee (a collective executive body). The collective executive body is responsible for all matters that do not fall within the authority of either the board of directors or the general participants’ meeting. The Board (management committee or board of governors) represents a collegial executive body made of individual persons only. Said persons may not be participants/shareholders in the company at the same time. The CEO of the company exercises the powers of the chairman of the

company Board. The jurisdiction of the Board and its decision-making is to be outlined in the LLC’s charter or internal documents of the company.

Usually, the company’s Board is entitled to (without limitation):

- decide on managing the day-to-day activities of the company;
- ensure the implementation of the decisions of the General participants’ meeting and the BoD;
- develop priority financial and business plans to be adopted by the BoD and approve internal documents of the company on matters within the jurisdiction of the executive bodies of the LLC;
- approve certain company transactions.

The Charter of LLC may provide for delegation to the BoD of some issues under the general meeting’s competence. The functions of Board can be performed by the CEO or the BoD if also provided by the Charter. The same rules are applied to the NJSC.

### **Joint Stock Company**

The general shareholders’ meeting constitutes the supreme governing corporate body. The general meeting’s competence of a PJSC cannot be extended. Decisions passed by the general meeting of JSC shareholders and list of shareholders who attended the meeting shall be confirmed by the person maintaining registry of the company. The shareholders are entitled to enter into shareholders’ agreements to re-distribute voting rights and to determine special contractual rules applicable to transactions with shares, etc.

Each common share carries one vote at the general shareholders meeting (except for cases of cumulative voting provided by law), and most resolutions are made by a simple majority



vote, although for certain key decisions a qualified majority of 75% is required. Owners of preference shares are entitled to vote only in special cases (specifically, liquidation or reorganization).

Russian law regulations with regard to minority shareholders apply equally to JSCs.

Shareholders in a JSC possess pre-emptive rights to acquire additional shares allocated as public offering or issuance shares in the amount proportionate to the number of shares of the same type that they possess.

Shareholders have equal access to the internal accounting documents of the JSC as well as appraisal reports, the list of JSC affiliates and other documents under the current legislation. A person that acquires more than 30% of the overall shares of a PJSC is obliged to issue a public offer to other shareholders of the respective types of shares and owners of issuance securities within 35 days of the time of entering the relevant credit entry in their personal account on the acquisition of such shares from them.

A person that acquires more than 95% of the shares in the charter capital of a PJSC as a result of voluntary JSC shares offers or obligatory shares offers is obliged to buy out the remaining shares that belong to the other shareholders as well as issuance securities.

Shareholders holding no less than 2% of voting shares overall of a JSC are entitled to bring issues to the agenda of the annual general shareholders' meeting and propose candidates for the board of directors (supervisory board) of the JSC, its collective executive body or its revision commission and also the candidacy for the CEO position. The day-to-day management of the JSC is performed by the General Director (Director). The functions of the CEO can be implemented by one Director, several persons acting jointly as one

CEO or by several CEOs, acting independently (also applicable to LLC). If it is provided for by the Charter, a collective executive body (where the General Director acts as the Chairperson) may be created. The JSC is able to delegate the powers of the executive body to the Managing company acting under special agreement. The executive body deals with all matters which do not come under the jurisdiction of either the BoD or the general meeting. The functions of the CEO are rather similar to those in an LLC.

For the PJSC existence of collective management body (supervisory or other board, BoD), which shall comprise not less than 5 members, is obligatory, for the purposes of protecting shareholder rights from violation by the management. CEO and members of collective executive bodies cannot preside and constitute more than one fourth of collegial management body's members. The powers of the BoD include the convocation and conduction of general meetings, the adoption of resolutions on the issuance of additional shares, etc. (these powers may be limited by the Charter).

### **Partnership**

The management in a partnership is carried out under the mutual consent of all partners, unless specific decision-making rules are stipulated by the Foundation Agreement. Limited partners, as mentioned, are not entitled to participate in management or carry out business on behalf of the partnership.

Each full partner is entitled to carry out business on behalf of the partnership, unless the Foundation Agreement indicates that business should be carried out either jointly or by certain partner(s). Due to this, partners in a full partnership are jointly and severally liable for the obligations of the entity, provided that such liability is not limited to the value of the investments.



Limited partners have no access to decision-making, however their liability for the partnership's obligations is limited. Also, the name of the limited partnership may not contain the names of limited partners (otherwise they shall be considered full partners). A partnership does not have any supervisory body, as such a form of legal entity is mostly considered an incorporation of individuals, rather than an incorporation of capital. Nonetheless, each partner is granted access to all of the partnership's documents and is entitled to demand information if the management of affairs is delegated to certain partner(s).

### **Business Partnership**

Similarly, to the JSC and the LLC, the creation and functioning of a sole executive body is put forward, which should be elected unanimously by individual partners only and bears liability for damages inflicted to the partnership.

The Management Agreement may define, inter alia, a special procedure for approving the actions of this sole executive body.

One of the main peculiarities of business partnerships is the delegation of significant discretionary powers in determining the means of management, the structuring of corporate relations, and the possibility of stipulating different regimes of partners' rights and duties. The embodiment of permissive regulation of the business partnership's activities is the Management Agreement, which is different from Foundation Agreements and Shareholders' Agreements.

Partners are able to regulate their internal corporate relationship (including the establishment of veto rights) to the full extent possible by entering into a Management Agreement.

The Management Agreement may stipulate the establishment of other bodies of the business

partnership. However, there are no restrictions on such bodies regarding their types, powers and functions.

### **Representative Offices and Branches**

The head of the subdivision administrates the affairs of branches and representative offices. Such a body should be appointed and empowered by Power of Attorney by the head company. The powers of the head of the subdivision may be transferred to third parties through another Power of Attorney, unless the head company restricts this.

It should be noted that rules on major and interested party transactions apply to branches and representative offices, hence certain corporate approval systems should be implemented by the head company if necessary.

## **3.2 Accounting and reporting requirements**

### **Limited Liability Company**

A peculiarity of the LLC is in the absence of mandatory information disclosure rules (the only case of an LLC being subject to disclosure is public bond issuance), but the need to furnish tax authorities with accounting information for taxation purposes. An LLC is obliged to keep information regarding its business activities, in particular: the resolutions of its general meetings, its certificate of state registration, local acts, lists of affiliates, etc. Any participant is entitled to access the given information.

It should be noted that under Russian Law, mandatory audit is required only for a limited range of business entities (regardless of the type of entity), engaged in certain cases provided by the law, e.g. for some types of activities, namely: banks and other credit organizations; insurance companies; commodity, currency or stock exchange companies; custodies companies; brokers; dealers; securities trust managing organizations; registrars, etc.



Being a rather closed business entity, an LLC is not subject to mandatory auditing, except in the case of public bond issuance. An audit may be voluntarily performed with the use of an independent auditor. Moreover, mandatory auditing must be conducted at the request of participants. A mandatory audit must also be conducted in the case that earnings for the period prior to the auditing period are more than RUB 400,000,000 (approx. 6,000,000 USD) or the value of company assets is more than RUB 60,000,000 (approx. 1,000,000 USD). Establishment of the internal audit commission is not also compulsory for the LLC if provided for in the Charter.

### **Joint Stock Company**

A JSC is required to disclose information and render accounts in accordance with special rules in cases provided by law (for example, when the securities of the JSC are approved for public circulation). In practice, the accounting in a NJSC is like that in an LLC, and an PJSC is subject to disclosure procedures and specific requirements.

The validity of the data contained in the annual reports and other accounts, in contrast to the LLC, are subject to mandatory verification by the internal audit commission – a special body to be created in the PJSC. In a NJSC as well as in an LLC it is not obligatory to establish internal audit commission provided that this is stipulated by the Charter. If the JSC is obliged to disclose information, it should involve an independent auditor in the auditing process.

### **Partnership**

Under Russian Law there are absolutely no specific requirements for accounting and mandatory auditing of partnerships.

### **Business Partnership**

There are no specific requirements regarding accounting in a business partnership or mandatory information disclosure.

The law does not define cases when mandatory auditing is required for business partnerships. Auditing should be conducted only if it is stipulated in the Charter or at the request of a partner.

### **Representative Offices and Branches**

Sufficient grounds for either a branch or representative office to perform accounting in Russia for taxation purposes are regular commercial activities on the territory of Russia. According to the official explanations of the Russian tax authorities, a regular character always applies to the commercial activities of those branches and representative offices which are registered (or are bound to register) with the Russian tax authorities (notwithstanding, there are several exceptions when commercial activities are not considered regular). It should be considered that such an obligation arises if a subdivision of a foreign head company implements any activities for a period exceeding 30 days in a year and creates any permanent work place. It is important to mention that the limited scope of activities performed by representative offices does not exempt them from profit tax in the same way as a branch, in those cases when a representative office is in fact engaged in commercial activity.

Russian legislation proscribes no obligation to audit a branch or representative office as a separate entity. However, the existence of such an obligation may be determined by the activities of the head company. In that case, a branch or representative office is subject to auditing as a part of the head company, rather than as a separate entity.

## **4. Foreign Investment, Capitalisation, Residency and Material Visa Restrictions**

### **4.1 Foreign Investment**

Foreign investments in Russia are regulated mainly by the Investment Law and the Law on





Strategic Investment. The Investment Law stipulates a principal according to which the legal regime of foreign investments and the use of profit gained as a result of such investments cannot be less favorable to Russian investors than the legal regime provided. It contains general principals and guarantees to protect foreign investors' rights, including: the right to freely (without licensing or quoting) import and export personal electronic data carriers, the right to buy shares and securities of Russian organizations, and the guarantee of fair compensation in the case of nationalization or requisition of property.

Foreign investments are defined by the Investment Law as the contribution of foreign capital (i.e., money or other assets) owned by the foreign investor to a business in the territory of the Russian Federation. Rights for the exploitation of natural resources and other rights under contracts are recognized as investments as well. A special term "foreign direct investment" is used to describe a portfolio investment representing no less than 10 percent of equity interest in the company, investment of capital assets in the branch of a foreign legal entity established in the territory of the Russian Federation, and the leasing of equipment (of a certain type and value) carried out by a foreign legal entity in the territory of the Russian Federation.

The Investment Law operates with categories of investment projects and priority investment projects. Priority investment projects enjoy preferential treatment, including tax benefits. To qualify as a priority investment project, the investment must meet certain requirements as regards the amount and procedure of approval. The Russian government maintains a list of priority investment projects.

Investment of foreign capital in banks and other credit organizations, insurance organizations, and non-commercial organizations (such as charities and scientific and religious organizations), and

also relations defining establishment procedure and termination of foreign banks' representative offices' and other foreign lending agencies' activity is subject to specific regulation under the corresponding Russian laws, such as the Law on Insurance, the Law on the Securities Market, the Law on the Protection of Investors' Rights and Lawful Interests in the Securities Market, the Law on Communal Associations, the Law on Banks and Banking Activity, etc.

The Investment Law guarantees national treatment of foreign investments, with certain exceptions. Special restrictions affecting foreign investors may be introduced only by federal laws where it is necessary to protect the fundamentals of the constitutional system, public moral health, the rights and lawful interests of other persons, and the defense and national security of the state.

The Investment Law provides a system of guarantees for direct foreign investments in Russia. These guarantees shall not apply to foreign capital deposited in banks or other credit institutions or insurance companies, as well as to foreign capital investment in non-profit organizations with a socially beneficial objective in the sphere of education, charity, science, or religion. These forms of investment are governed, respectively, by Russian laws on banks and banking activity, Russian insurance laws, and Russian laws on non-profit organizations. The system of guarantees include: fair, efficient, and adequate compensation in the case of investment nationalization or requisition; a grandfathering clause for priority investment projects in which the foreign investment share exceeds 25 percent (unfavorable subsequent amendments to tax legislation do not apply to existing priority investment projects for the period of return of initial investments but not for more than seven years); repatriation of income and proceeds from investments; and repatriation of assets and information previously imported to Russia as an



investment.

A special provision of the law recognizes the validity of the assignment of rights and obligations from a foreign investor to another entity. This is a standard clause required by many international financial institutions to underwrite international investment projects.

## 4.2 Capitalization requirements

### Legal entities

Contributions to the charter capital of a legal entity may be made in cash or in kind, and some customs benefits may be available for in-kind contributions made by foreign investors. In-kind contributions exceeding 20 000 RUB (approx. 300 USD) require evaluation by an independent assessor. The charter capital may be increased only after the original charter capital has been paid up in full.

Another option for legal entity financing is receiving a loan by a subsidiary from the mother company. It should be specifically mentioned that such loans may trigger thin capitalization rules in some cases.

The role of thin capitalization rules is to ensure that the interest rate under certain loan agreements between mother and subsidiary companies (referred to as “controlled” debt) corresponds to the market interest rate.

Thin capitalization rules only apply in cases where the mother company owns more than a 20% share in the subsidiary company and the gross debt amount under the loan agreement is 3 times higher than the equity of the subsidiary company (i.e. the debt is a “controlled” one), calculated for the respective quarter of the year.

To determine equity, the quarterly balance value of liabilities should be subtracted from the balance value of assets. Therefore, in the case that in the quarter when the loan was

issued (i.e. the debt amounts to 3 bln USD), the equity of the subsidiary is 1 bln USD or less (example: asset value of 1.5 bln USD and liabilities amounting to 0.7 bln. USD), thin capitalization rules will apply.

In the case of the debt being deemed a “controlled” one, thin capitalization rules on interest rate calculation apply. The taxpayer should confirm that the interest rate under such a loan agreement is not higher than the rate calculated in accordance with art. 269 of the Tax code of the Russian Federation. If the interest rate under a “controlled” debt is higher than the rate calculated in accordance with art. 269 of the Tax code of the Russian Federation, the exceeding amount is considered as dividends of the mother company and is subject to tax according to the rate specified in the double tax treaty, while the calculation of the interest rate under art. 269 may only be deducted as an expenditure for the purposes of corporate income tax.

It should also be noted that the law sets a maximum interest rate that may be deducted as an expenditure. For loan agreements concluded in 2017 this rate is calculated as the Bank of Russia official refinancing rate (8.5% as of this Review) multiplied by 1.1, so it is equal to 9.35%. This rate is equal to 9% for loans granted in foreign currency.

Therefore, to comply with thin capitalization rules and in order to minimize the risks of additional dividends taxation under “controlled” debt, the mother company is presented with two possible options. The first one is to try to avoid the creation of “controlled” debt. This may be done by ensuring that the balance value of assets at the end of each quarter exceeds the amount of the balance value of liabilities by more than 1 bln USD. In this case the equity of the subsidiary shall be more than 1 bln USD, thus the debt under the loan



agreement will not be a “controlled” one (the 1:3 ratio shall not be met) and the thin capitalization rules will not apply.

In cases when the 1st option cannot be realized and the debt is qualified as a “controlled” one, the interest rate under the debt must be compared with the rate specified by art. 269 of the Tax code of the Russian Federation. Also, it is recommended that the interest rate under “controlled” debt does not exceed 9.35% (for loan agreements concluded in 2017), as only the interest amount calculated at this rate may be deducted from the corporate income tax base as an expenditure.

### **Representative Offices and Branches**

Both branches and representative offices are provided with assets by the head company in accordance with its Charter. The assets of the subdivision should be simultaneously accounted on the balance sheets of the branch or representative office and of the head company.

It should be considered that the head company is liable for debts incurred in connection with the affairs of the branch or representative office with all its property rather than only that allotted to the particular subdivision.

### **4.3 Residency, visa and migration issues in the employment of foreign employees**

Employment and migration requirements are provided for by the Labor code of the Russian Federation (hereinafter – “The Labor Code”), the Federal Law "On the Legal Status of Foreign Citizens in the Russian Federation", and the Federal Law "On the Migration Registration of Foreign Citizens and Stateless Persons in the Russian Federation".

According to the Constitution of the Russian Federation, Russian citizens, foreign citizens, and persons without citizenship have equal

access to work.

It should be noted that in case the company decides to employ foreign citizens in Russia, the company will need to obtain work visas for them as a business visa does not grant the right to work.

Foreign citizens can be hired as ordinary employees or as highly-qualified specialists (hereinafter – “HQS”). The hiring procedure and time-frames depend on the status of the foreign citizens involved.

Please note that it is also a decisive point whether the company would like to employ the CEO and members of staff as HQS under Russian law. A HQS is an employee with an annual salary amounting to 167 000 Russian rubles per one calendar month. A HQS may benefit from a simplified procedure of obtaining a work permit. In case the CEO and staff do not qualify for the HQS requirements and are employed on a general basis, the relevant permit procedure is more complex and now also includes passing complex examination on Russian language, Russian history and fundamentals of Russian legislation. Please kindly note that in the Russian Federation, the company wishing to use the services of foreign employees should have reserved a quota for such employees before May of the year preceding the year of hiring. Only specialists for the jobs announced by the Ministry of Health and Social Development in the quota-exempt professions list can be hired beyond the quota.

The alternative option (which does not require quota reservation) is to hire foreigners as HQS. This will be possible if the foreigners have certain skills and achievements in the area they are going to be employed and if their annual salary will be no less than 167 000 Rubles per month as already mentioned above.

### **Procedure of hiring a foreign employee**

It should be noted, in 2016 the Federal



Migration Service (FMS) powers have been transferred to the Russian Federation Ministry of the Interior (“MVD”).

The following main steps shall be made by the company to hire an expatriate under the ordinary work permit procedure:

- Obtaining a decision from the State Employment Centre for the company confirming the reason for engaging the foreign employee;
- Applying for a quota of foreign employees that the company may hire per annum (no quota requirements for the CEO, the managerial staff and HQS);
- Obtaining permission for the company to engage and use a foreign workforce, issued;
- Obtaining a work permit issued for the employee;
- Obtaining a registration card for the company that allows it to obtain invitation letters and convert visas;
- Obtaining an invitation letter for the visa issued;
- Obtaining a work visa for the employee (done by him/herself);
- Registering the employee with migration authorities;
- Notifying the required authorities on hiring the foreigner;

It usually takes no less than 3 months from the date of the submission of the required documents to the state authorities to obtain a work permit plus the time for the collection of all the necessary documents and the preparation of the required application and other relevant forms.

### HQS

The following steps shall be taken to hire a highly-

qualified foreign specialist:

- Registering the Company and obtaining the registration card that allows the Company to obtain invitation letters and convert visas;
- Obtaining a work permit for the employee;
- Notifying the tax authority about the hiring;
- Obtaining an invitation letter for the visa;
- Obtaining a work visa for the foreign employee;
- Registering the employee with migration authorities;
- Carrying out other registrations and regular reporting to the state authorities after the foreigner is hired.

The estimated time for obtaining a work permit is from 14 business days to 1 month from the date of submission of the required documents to the state authorities plus the time for collection of all necessary documents and preparation of the required application and other relevant forms.

### Visa issues

To enter the Russian Federation a foreign citizen must submit a valid identity document, accepted as such by the Russian Federation, and a visa, if no other means of entry into the Russian Federation is established by an international agreement. As a whole, a visa under the legislation of the Russian Federation is a document, permitting staying in Russia for a specific period of time. Business visas are issued to foreigners who visit Russia for the purposes of official or private business, i.e. visas are intended for foreign citizens who arrive in Russia to meet with their business partners, sign contracts, etc. The procedure



and terms of the issuance and provision of a visa, the extension of its validity period, its re-issuance in case of loss, and the visa cancellation procedure, are established by the Government Regulation of the Russian Federation.

Depending on the purpose of entry into Russian Federation and the lodgment purpose a foreign citizen can be given a diplomatic, service, ordinary, transit, and temporary residence visa.

There are 7 main types of ordinary visas for visiting the Russian Federation:

- personal visa;
- business visa;
- tourist visa;
- educational visa;
- work visa;
- humanitarian visa;
- visa for entry into Russian Federation with the purpose to obtain political asylum;
- visa to receive Russian citizenship.

According to Russian legislation visas may be issued with up to two entries and for up to 90 days. However, you can use multiple-entry business visas, valid for 6 or 12 months but with unlimited entries/exits.

In practice, the following types of Russian business visas exist in Russian jurisdiction:

- Single entry, valid for up to 3 months;
- Double entry, valid for up 3 months;
- Multiple entry visas.

The Law on Amendments to the Law on the Legal Status of Foreigner Citizens increases the maximum validity period of the work permit for foreign qualified professionals for up to three years instead of the one year that was used

before. Moreover, the accompanied work visa will be valid for a maximum of three years also. However, the duration period of the work permit and work visa cannot exceed the term of the labor agreement concluded with the foreign specialist. The work permit along with the work visa can be prolonged upon the employee's request, also for up to three calendar years.

#### **Procedure and terms of obtaining a business visa**

To obtain a visa a foreign national should apply to a diplomatic or a consular representative office of the Russian Federation in person or via his legal representative and should submit the following documents:

- a valid identity document, accepted as such by the Russian Federation;
- a completed visa application form with one photograph;
- one photograph (30x40 mm);
- a medical insurance policy, unless otherwise provided for by international agreements of the Russian Federation;
- an additional certificate proving that the applicant does not have HIV (AIDS), in cases where the foreign national applies for a visa for a term exceeding three months. An ordinary business visa is issued for a foreign citizen entering the Russian Federation for the purpose of making business activities. An ordinary business visa can be a single or double lasting up to 3 months, or a multiple lasting up to 1 year.

Ordinary business visas are issued based on an invitation to enter the territory of the Russian Federation, issued in accordance with the legislation of the Russian Federation and the decisions of the Ministry of Foreign Affairs of the Russian Federation, directed to the





diplomatic mission or consular office of the Russian Federation. An ordinary business visa can also be issued based on a decision of the head of the diplomatic mission or consular office of the Russian Federation in connection with the necessity to enter the territory of the Russian Federation to participate in international and national official, economic, social, political and scientific events on the basis of a written application of a foreign citizen.

#### **4.4. Any restrictions on remitting funds out of jurisdiction**

Current currency regulations establish basic rules of currency regulation and control. A currency transaction report form is required for certain transactions (for instance, exterior trade and loans at Russian banks). The main requirements in respect to currency transaction report forms are set out by the Regulations of the Bank of Russia.

A Russian counterparty must comply with these requirements in connection with payments to another counterparty (import or export transactions). A currency transaction report form is issued in the process of foreign exchange operations in connection with foreign trade transactions, if the contract amount exceeds the equivalent of 50,000 USD at the official exchange rate of foreign currencies in relation to the Russian ruble, defined by the Bank of Russia at the date of the contract's conclusion.

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# INTERNATIONAL LAWYERS NETWORK



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KOREA



ESTABLISHING A BUSINESS ENTITY IN SOUTH KOREA

Introduction

South Korea remains a very popular location for foreign companies to establish new businesses. Since the end of the Korean War, South Korea has rebuilt itself from a country that had a lower GNP than North Korea into the economic powerhouse that it is today. Boasting some of the largest and most well-recognized brands in the world, South Korea has become a prime player in the global marketplace. Its extensive experience with global commerce has contributed to shaping its culture and business climate. South Korea retains its traditional Asian culture while at the same time understanding and embracing many Western ideas and approaches to business. History and tradition coexist with high technology and modern sophistication. This combination of East and West establishes South Korea as the

gateway to Asia for many foreign companies. It enables these companies to obtain a foothold in Asia, while operating in an environment that is definitely Asian, but that also feels somewhat familiar to Western businesses.

This article provides a general description of business forms and some of the issues that should be considered when establishing a new business entity in South Korea (hereinafter "Korea.") But each individual situation is unique and any person or company considering establishing a business entity in Korea should consult with counsel to obtain specific legal advice on their particular situation.

Foreign companies can do business in Korea by (1) establishing a Korean subsidiary of a foreign entity; (2) opening a branch office; or (3) establishing a liaison office in Korea.

Item	Method	Applicable Law	Remarks
1	<b>Subsidiary of a foreign entity</b>	Foreign Investment Promotion Act, Korean Commercial Code	Acknowledged to be foreign direct investment
2	<b>Branch office of a foreign entity</b>	Foreign Exchange Transactions Act	Classified as a local branch of a foreign entity in Korea
3	<b>Liaison office</b>		

1. Korean Subsidiary of a Foreign Entity

Foreign direct investment, conducted by establishing a Korean subsidiary of a foreign entity (individual or corporation), is governed by the Korean Commercial Code ("KCC"). The entity created is treated the same as any other Korean entity. A local subsidiary has a legal existence and is a separate legal entity from its foreign headquarters (separate accounting and settlement). In order for the local subsidiary

to be subject to the Korean Foreign Investment Promotion Act, a foreigner is required to invest not less than KRW 100 million and the foreigner must own at least 10% of the total number of voting shares issued by the subsidiary Korean joint stock company (or at least 10% of the total amount of equity investment in the subsidiary if it is a limited member company). Please see below for the types of



local subsidiaries available in Korea and their characteristics.

## 2. Korean Branch of a Foreign Company

A Korean branch, established by a foreign entity, consists of either a branch office or a liaison office. The choice depends on the proposed business activities of the entity. If the Korean branch conducts business activities generating profits in Korea, it is classified as a “branch.” This would not be a Korean entity; it would be deemed to be the same entity as its foreign parent.

A foreign company intending to conduct normal business activities in Korea must appoint a person to represent the branch, follow procedures to establish a branch pursuant to the Foreign Exchange Transactions Act and register such establishment with the court. The branch so registered is recognized to be a permanent establishment under the Korean tax laws. Thus, the income generated from its business activities in Korea would be subject to the same corporate tax rate as any other Korean entity. A branch must register its business. No restrictions exist as to the (minimum/maximum) amount of investment permitted.

## 3. Liaison office

A liaison office of a foreign entity may not engage in direct profit-making business activities in Korea. It performs only non-revenue-producing business functions such as developing business contacts, market research and other research and development activities. Unlike a branch, it is not required to register with the court or file a business registration. A Korean tax office assigns an identification number to a liaison office. This would be equivalent to a business registration.

## 1. Types of business entities

The process for incorporating a Korean subsidiary of a foreign entity is identical to the process for incorporating any other type of Korean entity in Korea. The only significant difference is that a foreign entity will need to go through an additional process that is required under the Foreign Investment Promotion Act.

### ● Description of the types of entities available in each jurisdiction through which to conduct business

There are essentially five types of business entities available in Korea. They are the following:

1. Joint stock company (chusik hoesa)
2. Limited member company (yuhan hoesa)
3. Partnership (hapmyeong hoesa)
4. Limited Partnership (hapja hoesa)
5. Limited Liability Company (yuhan chaekim hoesa)

Each of these forms of business entity will be discussed below.

### 1.1 Joint stock company (chusik hoesa)

The corporate form most commonly used by foreign investors doing business in Korea is a “joint stock company” (chusik hoesa), which is similar to a joint stock company in other jurisdictions. This form imposes more regulatory requirements on a business than some of the other available business entities. Therefore, generally a joint stock company is appropriate for larger business operations, especially if it is anticipated that the business will become a publicly traded company at some point. A joint stock company is required to appoint a board of directors. It also must appoint at least one director who is automatically deemed to be the



Representative Director if only one director is appointed.

A joint stock company generally is required to publish its financial statements in a designated newspaper. The financial statements must be approved by the shareholders at the annual general meeting of shareholders. Moreover, a joint stock company is required to appoint a statutory auditor if the company's paid-in capital is equal to or exceeds 1Billion KRW. Additionally, the annual financial statements of a joint stock company must be audited by external auditors if the company is publicly traded or certain other asset/liability thresholds<sup>[1]</sup> are triggered.

### **1.2 Limited member company (yuhan hoesa)**

The second most common form of business entity is a "limited member company" (yuhan hoesa). (Members' liability is limited to the amount each invested; they have no additional liability to the company's creditors.) It is a "closed" company, similar to limited liability companies in the U.S. or a German GmbH. Generally, the limited member company structure is more suitable for smaller operations because it is subject to less stringent regulations and has a more

streamlined management structure compared to a joint stock company.

Like a joint stock company, a limited member company is required to appoint at least one director who is automatically deemed to be the Representative Director if only one director is appointed. A board of directors is optional for a limited member company. Additionally, a limited member company is not required to publish its financial statements as is a joint stock company. Likewise, limited member companies are not required to appoint a statutory auditor and are not subject to any audit requirements.

A summary of the major differences between a joint stock company and a limited member company are set forth in the table below:

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<sup>[1]</sup> More specifically, a joint stock company's annual financial statements must be audited by external auditors if: (i) the company is listed on the Korea Exchange or will be listed on the Korea Exchange within the relevant financial year or the following financial year; (ii) it has total assets of 10B KRW or more as of the end of the immediately preceding financial year; (iii) it has total assets of 7B KRW or more and total liabilities of 7B KRW or more as of the end of the immediately preceding financial year; or (iv) it has total assets of 7B KRW or more and an employee headcount of 300 or more as of the end of the immediately preceding financial year.





	Joint stock company ( <i>chusik hoesa</i> )	Limited member company ( <i>yuhan hoesa</i> )	Notes
Generally,	<ul style="list-style-type: none"> <li>This is the most often used corporate vehicle for foreign investors doing business in Korea.</li> <li>Analogous to a U.S. joint stock company.</li> </ul>	<ul style="list-style-type: none"> <li>Analogous to a U.S. limited liability company or German GmbH.</li> <li>Useful in cases where (i) there is to be a limited number of owners; and (ii) want to minimize corporate formalities. (transfer of ownership interests is allowed, but may be limited by the articles of incorporation)</li> </ul>	<ul style="list-style-type: none"> <li>Yes, there is a substantive difference between a joint stock company and a limited member company.</li> </ul>
Owner of equity interest	<ul style="list-style-type: none"> <li>Generally referred to as a “shareholder”.</li> </ul>	<ul style="list-style-type: none"> <li>Generally referred to as a “member”.</li> </ul>	<ul style="list-style-type: none"> <li>No substantive difference, i.e. semantic difference only and there is no substantive difference between a joint stock company “shareholder” and a limited member company “member.”</li> </ul>
Liability of Shareholders/ Members	<ul style="list-style-type: none"> <li>Limited to investment amount (i.e. limited liability).</li> </ul>	<ul style="list-style-type: none"> <li>Same as a joint stock company.</li> </ul>	<ul style="list-style-type: none"> <li>No substantive difference.</li> </ul>
Initial Incorporation Process	<ul style="list-style-type: none"> <li>At least one (1) “promoter” required to undertake all incorporation related matters.</li> <li>“Promoter” later becomes the shareholder of the joint stock company. [NOTE: The “Promoter” would be the Parent.]</li> </ul>	<ul style="list-style-type: none"> <li>No “promoter” required.</li> </ul>	
Minimum Capital Requirement	<ul style="list-style-type: none"> <li>100 KRW per share and one share or 100 KRW total (i.e. 100 KRW total=100 KRW x one share).</li> <li>If the articles of incorporation allow, no par value stock may be issued. There is no minimum capital requirement.</li> <li><i>Typically, however, for foreign investors the minimum paid in capital is at least 100M KRW total (e.g. 5,000 KRW per share, total 20,000 shares) because that is the minimum amount required to qualify as a foreign investor under FIPA.</i></li> </ul>	<ul style="list-style-type: none"> <li>100 KRW per share. There is no minimum capital requirement.</li> <li>Same as joint stock company with respect to typical minimum for foreign investors.</li> </ul>	<ul style="list-style-type: none"> <li>Yes, there is a substantive difference, but not for foreign investors given the minimum amount required to qualify as a foreign investor under FIPA is the same for both a joint stock company and a limited member company.</li> </ul>



	Joint stock company ( <i>chusik hoesa</i> )	Limited member company ( <i>yuhan hoesa</i> )	Notes
Authorized Capital and Issued Capital	<ul style="list-style-type: none"> <li>The number of shares issued at the time of incorporation must be at least 10% of the total number of authorized shares.</li> <li>Thereafter, new shares can be issued (up to the number of authorized shares) by a resolution of the board of directors, and the number of authorized shares can be increased by amending the articles of incorporation, which requires a special resolution of the shareholders.</li> </ul>	<ul style="list-style-type: none"> <li>There is no authorized capital - note however minimum capital amount (100M KRW) required for foreign investor under FIPA.</li> <li>The actual paid in capital amount is specified in the articles of incorporation and any increase in the paid in capital amount requires an amendment to the articles of incorporation, which requires a special resolution of the members.</li> </ul>	<ul style="list-style-type: none"> <li>Yes, there is a substantive difference - issuance of additional capital is more difficult for a limited member company.</li> </ul>
Classes of Shares	<ul style="list-style-type: none"> <li>Various types of stock may be issued. (Stock that may limit the stockholder's right to vote on certain issues may be issued)</li> </ul>	<ul style="list-style-type: none"> <li>Typically, one class.</li> </ul>	<ul style="list-style-type: none"> <li>No substantive difference unless different classes of shares are necessary to accommodate varying levels/amounts of investment between co-investors.</li> </ul>
Number of Owners	<ul style="list-style-type: none"> <li>Minimum of one (1) shareholder; no maximum.</li> </ul>	<ul style="list-style-type: none"> <li>Minimum of one (1) member</li> </ul>	<ul style="list-style-type: none"> <li>No substantive difference -</li> </ul>
Transfer of Ownership Interest	<ul style="list-style-type: none"> <li>Freely transferable subject to any contractual restrictions between shareholders (e.g. shareholder agreement).</li> </ul>	<ul style="list-style-type: none"> <li>Transfer of ownership interest is allowed, but it may be limited by the articles of incorporation.</li> </ul>	<ul style="list-style-type: none"> <li>No substantive difference -</li> </ul>
Shareholders' Meeting or Members' Meeting	<ul style="list-style-type: none"> <li>Shareholders may adopt resolutions on important issues concerning a joint stock company.</li> </ul>	<ul style="list-style-type: none"> <li>Members may adopt resolutions on all issues concerning a limited member company.</li> <li>One share has one vote, but this may be modified by the articles of incorporation.</li> </ul>	<ul style="list-style-type: none"> <li>Yes, there is a substantive difference - members of a limited member company have more flexibility.</li> </ul>
Shareholders' Meeting or Members' Meeting Resolutions	<ul style="list-style-type: none"> <li>Written voting is allowed as long as it is permitted by the articles of incorporation.</li> <li>Proxies are permitted.</li> <li>If the company's paid in capital is less than 1B, written resolutions are permitted. [NOTE: For companies with less than 1B paid in capital, written resolutions are</li> </ul>	<ul style="list-style-type: none"> <li>Unanimous written resolutions of all members are permitted.</li> </ul>	<ul style="list-style-type: none"> <li>Yes, there is a substantive difference - members of a limited member company have more flexibility.</li> </ul>



	Joint stock company ( <i>chusik hoesa</i> )	Limited member company ( <i>yuhan hoesa</i> )	Notes
	<p>allowed. Written resolutions allow the shareholders to resolve a matter without a face-to-face meeting (i.e. the company can send the agenda for a particular shareholders' meeting to the shareholders and the shareholders may vote by returning the agenda with a vote).</p>		
Board of Directors	<ul style="list-style-type: none"> <li>• Required.</li> <li>• Board is subject to the KCC with respect to its activities.</li> <li>• The selection of the members of the board of directors is made by having the same specified in the articles of incorporation.</li> <li>• [NOTE: There are no restrictions regarding nationality or residency for directors and representative directors.]</li> <li>• If more than one director is selected, then (i) each director independently represents the Subsidiary or the directors jointly represent the Subsidiary, as so specified or approved; or (ii) one or more directors are designated as representative director(s) (i.e. the representative of the Subsidiary).</li> </ul>	<ul style="list-style-type: none"> <li>• A Board of Directors is not required but at least one (1) director is required.</li> <li>• If a Board of Directors is appointed pursuant to the articles of incorporation/resolution of members, such board will not be subject to the KCC with respect to its activities because it is not a statutorily recognized board.</li> <li>• If more than one director is selected, then (i) each director independently represents the Subsidiary or the directors jointly represent the Subsidiary, as so specified or approved; or (ii) one or more directors are designated as representative director(s) (i.e. the representative of the Subsidiary).</li> </ul>	<ul style="list-style-type: none"> <li>• Yes, there is a substantive difference - members of a limited member company have more flexibility.</li> </ul>
Board of Directors Resolutions	<ul style="list-style-type: none"> <li>• Audio conferences are permitted.</li> <li>• Written resolutions are not permitted.</li> </ul>	<ul style="list-style-type: none"> <li>• No restriction because any board organized under a limited member company is not a statutorily recognized board.</li> </ul>	<ul style="list-style-type: none"> <li>• Yes, there is a substantive difference - members of a limited member company have more flexibility.</li> </ul>
Directors	<ul style="list-style-type: none"> <li>• A minimum of one (1) director<sup>[2]</sup> required.</li> <li>• If the paid in capital is 1B KRW or more a minimum of three (3)</li> </ul>	<ul style="list-style-type: none"> <li>• A minimum of one director is required (regardless of whether a board is appointed).</li> <li>• A minimum of one (1)</li> </ul>	<ul style="list-style-type: none"> <li>• Yes, there is a substantive difference - members of a limited member company have more flexibility.</li> </ul>

<sup>[2]</sup> The responsibilities, roles and powers of a director and representative director are governed by the articles of incorporation.



	Joint stock company ( <i>chusik hoesa</i> )	Limited member company ( <i>yuhan hoesa</i> )	Notes
	<p>directors is required.</p> <ul style="list-style-type: none"> <li>A minimum of one (1) representative director.</li> </ul>	<p>representative director.</p>	
Statutory Auditor	<ul style="list-style-type: none"> <li>If the paid in capital is 1B KRW or more a minimum of one statutory auditor<sup>[3]</sup> or an audit committee is required.</li> </ul>	<ul style="list-style-type: none"> <li>Not required - but recommended so as to maintain accurate books and records.</li> </ul>	<ul style="list-style-type: none"> <li>Yes, there is a substantive difference - members of a limited member company have more flexibility.</li> </ul>
Dividends	<ul style="list-style-type: none"> <li>Under the KCC, dividends can be declared and paid only pursuant to a shareholder approval given at the annual general meeting of shareholders, provided that, if the subsidiary's articles of incorporation authorize "interim dividends", then the board can additionally declare a dividend during a given financial year (i.e. up to a total of 2 dividend payments a year, consisting of annual dividends and interim dividends). Depending on the financial status of the company, the total outstanding debt, and the specific industry, there may be minimum reserve requirements.</li> </ul>	<ul style="list-style-type: none"> <li>Under the KCC, dividends can be declared and paid only pursuant to a member approval given at a meeting of the members, provided that, if the subsidiary's articles of incorporation authorize "interim dividends", then the board can additionally declare a dividend during a given financial year (i.e. up to a total of 2 dividend payments a year, consisting of annual dividends and interim dividends). Depending on the financial status of the company, the total outstanding debt, and the specific industry, there may be minimum reserve requirements.</li> </ul>	

<sup>[3]</sup> Any person not a director of the Subsidiary or its affiliate may be designated as a statutory auditor. In contrast, to form an audit committee, the members and form of the committee must satisfy certain strict requirements. Therefore, appointment of a statutory auditor is preferred.



### 1.3 Partnership (*hapmyeong hoesa*)

A “partnership” (*hapmyeong hoesa*) is a type of business entity consisting of two or more members with unlimited liability. Members of the partnership are directly and jointly responsible, without limitation, for debts and liabilities accrued by the business. Thus, creditworthiness of each of the members is critical. A partnership is formed based on articles of incorporation jointly prepared by two or more members to which seals or signatures of all the members are affixed. In principle, members of the partnership have the authority to conduct partnership business and to represent the partnership. In order to assign the position of a member, the member must obtain consent from all of the other members. Internal relations of the partnership are subject to provisions of the Korean Civil Act on association (*johap*) unless otherwise provided by the articles of incorporation or the Korean Commercial Code.

### 1.4 Limited Partnership (*hapja hoesa*)

A “limited partnership” (*hapja hoesa*) is a type of joint business entity in which a combination of members with unlimited liability and members with limited liability together invest in a business. It might be deemed similar to a limited partnership entity in the United States, containing general partners and limited partners. Members with unlimited liability operate the business and may be held personally liable, while members with limited liability may or may not operate the business and are liable only up to the amount they invested. Many business entities outside of Korea exist in a form similar to a *hapja hoesa*. Because of the revisions to the KCC, those entities now can establish themselves as a *hapja hoesa* in Korea. This form of organization may appeal to some foreign

companies that operate in a similar form in their home countries.

The revised Korean Commercial Code (KCC) allows for a relatively new business form, *yuhan chaekim hoesa*, which may limit the liability of its members.

### 1.5 Limited Liability Company (*yuhan chaekim hoesa*)

A “limited liability company” (*yuhan chaekim hoesa*) is a legal entity in which all its members have limited liability, and its incorporation procedures are simpler than that of a joint stock company. The incorporation process of a *yuhan chaekim hoesa* generally includes drafting the articles of incorporation, payment of investment capital and registration of *yuhan chaekim hoesa*. Unlike a joint stock company, a *yuhan chaekim hoesa* does not need to go through such processes as stock subscription and appointment of directors or statutory auditors.

As a *yuhan chaekim hoesa* allows its members to have limited liability and has simpler incorporation procedures, we expect many venture companies, joint ventures, special purpose companies for acquisition of other companies and funds such as private equity funds may use this new corporate form.

A summary of the major differences between a limited member company and a limited liability company are as follows:

A limited liability company is similar to a limited member company. But a limited liability company provides greater flexibility. For example, while a limited member company is required to appoint a director and conduct a general meeting of members, a limited liability company does not need to undertake those actions. Additionally, a member is authorized to conduct business in a limited liability company while it is a director or representative director





that conducts business in a limited member company. A limited liability company allows each member to have only one voting right while a limited member company allows one voting right per investment unit.

### **Matters to be considered when choosing a particular business entity type**

There are a variety of factors to consider when deciding what type of business entity would be best suited for a particular business. These include: the purpose of the business; the size of the business; the form of the parent company business; whether the business might wish to go public in the future; the difficulties and expense of regulatory requirements; the level of privacy that is desired by the business; the ability of the parent company to closely monitor the activities of the business in Korea; etc.

## **2. Steps and Timing to Establish Foreign Subsidiary Entity in Korea**

- 1) Report on foreign investment (KOTRA, foreign exchange bank)
- 2) Remittance of an investment fund (foreign exchange bank, carrying into the country (customs declaration))
- 3) Registration of incorporation (court registry office)
- 4) Report on incorporation and business registration (tax office, KOTRA)
- 5) Transfer of paid-in capital into a corporate account (foreign exchange bank)
- 6) Registration of a foreign invested company (the first organization that receives a report on foreign investment)

### **2.1 Procedure for Incorporation of a Foreign Subsidiary Entity in Korea**

The initial decisions that need to be made concerning forming a corporate entity are the following:

(There are five forms of entities recognized under the Korea Commercial Act, but most foreign companies choose to form a joint stock company (*chusik hoesa*). So, we will explain below the procedures generally for establishing a joint stock company.)

1. Form of subsidiary - Joint stock company, Limited member company (*yuhan hoesa*), Partnership (*hapja hoesa*), Limited partnership (*hapja hoesa*) or Limited liability company (*yuhan chaekim hoesa*);
2. Name of Subsidiary (English and Korean);
3. Office lease for Subsidiary;
4. Authorized number of shares, par value of shares and the number of issued shares<sup>[4]</sup> of the Subsidiary (if to be incorporated as a joint stock company);
5. Identification of representative director, directors, and statutory auditor of Subsidiary;
6. Projected amount of the total foreign investment in the Subsidiary (for purposes of FIPA Notification);
7. Articles of incorporation for Subsidiary; and
8. Power of Attorney (notarized) to law firm authorizing law firm to prepare and file the FIPA Notification, and prepare, execute, and deliver all other documents for the limited purpose of incorporating and registering Subsidiary.

### **2.2 Foreign investment notification**

Also, prior to registration of the entity, there will need to be an inaugural general meeting of

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<sup>[4]</sup> To qualify as a foreign investor under FIPA, the initial investment must be at least 100M KRW. Therefore, if a Subsidiary will have 10,000 total authorized shares and each share is worth 10,000 KRW then all 10,000 shares will need to be subscribed and paid for.



the shareholders/members and a meeting of the board of directors (if applicable), where the representative director, other director(s) and statutory auditor (if applicable) are duly appointed. Our firm can prepare the minutes of such inaugural meeting in customary form once the business owner identifies the relevant persons.

Before incorporating and registering the entity, the company performing the entity should file a report as to its foreign investment in the entity to be formed (“**FIPA Notification**”) under the Foreign Investment Promotion Act (the “**FIPA**”). The FIPA Notification can be made with a foreign exchange bank<sup>[5]</sup> in Korea and the minimum requirements for qualification as a foreign investor (in addition to submission of all required documents and information described further below) are: (i) the initial paid in capital must be at least 100M KRW<sup>[6]</sup>; and (ii) at least 10% of the new entity must be owned/controlled by a foreign investor.

The FIPA Notification will allow the Parent and new entity to be eligible for certain favorable treatments as a foreign investor or foreign invested entity (to the extent applicable), including generally, guaranteed overseas

remittance<sup>[7]</sup>, treatment comparable to Korean nationals (i.e. foreign investors will receive substantially equal treatment in terms of their business activities as Korean companies), favorable tax treatments (depending on the size of investment, industry sector and location of business, as well as satisfaction of certain requirements under regulations relating to tax reduction and exemptions for foreign investment), facilitated customs clearance for certain capital goods, exemptions from certain customs duties for capital goods, and favorable lease terms for properties owned by the Korean national government or local governments (usually applicable to businesses that have large factories or manufacturing plants), among other things.

If there are multiple foreign investors forming the entity but one or more of those foreign investors fails to make the FIPA Notification, then that failure may raise unnecessary questions from the applicable authorities that could ultimately delay establishment of the entity.

The second phase of the process involves capitalization, registration, and incorporation of the new entity. This will entail paying in the initial capital, submitting certain registration forms, applications and supporting documents, and finalizing the incorporation. Finally, once the new entity is capitalized and incorporated, it will need to be further registered with the local tax office (which will issue a business registration certificate) and as a foreign-invested company with a foreign exchange bank.

After all the required documents are prepared and paid-in capital is transferred into Korea,

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<sup>[5]</sup> “Foreign exchange bank” refers to virtually any bank doing business in Korea. Once a foreign investor designates a bank for this purpose, in principle, all additional and subsequent investments (i.e. capital increases) with respect to the Subsidiary must be made through such bank, unless and until the party changes the designated foreign exchange bank to another bank.

<sup>[6]</sup> This amount is a “per foreign investor” amount, i.e. if three foreign investors are to invest in a Korean subsidiary, to qualify as a foreign direct investor under FIPA each foreign investor will be required to make a 100M KRW investment, which will mean a total investment of 300M KRW in the Korean subsidiary. 100M KRW is approximately US\$ 84,000.00 at current exchange rates.

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<sup>[7]</sup> Remittance is guaranteed for dividends and capital from the sale of shares and equity owned by the foreign investor, depending on the contents of the permission or report at the time of the remittance.



then this entire process may take roughly 7 business days to 10 business days under normal circumstances.

### 3. Governance, Regulation and Ongoing Maintenance

- Brief summary of regulation of each type and ongoing maintenance, reporting requirements

Each of the entities described above are required to provide reports of various types to Korean government entities on an annual basis. The types of reporting required and the government entities to whom such reporting must be made varies, depending on the type of entity that has been formed. There are additional reporting requirements for extraordinary activities, such as terminating a business entity.

- Requirements for local shareholding/directors

Shareholders, members, partners, and directors of the various entities described above need not be residents of Korea.

- Minority shareholders' rights and protection

Korean law does provide for rights and protection of minority shareholders and members under the Korean Commercial Code.

### 4. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions

As noted above, the FIPA provides certain distinct advantages to foreign companies that create business entities in Korea. But it also imposes certain obligations on those parent companies in order to reap the benefits of the Act. The benefits and general requirements are mentioned in the section on Steps and Timing to Establish above.

Some additional foreign investment benefits are the following:

- **Benefits regarding Tax and Customs Duties**

Foreign investments in projects that are conducted under the Restriction of Special

Taxation Act (e.g. foreign investments in projects designed to strengthen the global competitiveness of Korean industries) are subject to a reduction or exemption from corporate tax, income tax, acquisition tax and property tax. If certain capital goods are used for projects intended to strengthen Korea's global competitiveness, then such foreign investment is exempted from customs duties, special consumption tax and value added tax. Additionally, if a foreign invested company increases capital, the increased portion is exempted from corporate tax, customs duties, etc.

- **Cash Grants**

If a foreigner conducts a business requiring sophisticated technology in Korea, the foreigner may be provided with a cash grant to help defray some of the cost of the technology.

- **Free Trade Zone Benefits**

To promote and attract foreign investment, the Korean government has designated a foreign investment zone, free trade zone, free economic zone, etc. The government imposes different eligibility requirements for locating in a particular zone and for the different types of business to be attracted. Additionally, there are different investment incentives (rent, tax, customs duties, cash grants) available for each.

- **Any significant barriers to entry for an offshore party?**

Outside of the need to comply with the FIPA, there are no significant barriers to entry for a foreign company to establish an entity in Korea.

- **Any capitalization obligations?**

As mentioned above, there is an initial paid in capital obligation of at least 100 Million KRW per foreign investor under the FIPA.

- **Any special business or investment visa issues?**

Foreigners need to obtain a visa issued by Korean government authorities located abroad before



entry into Korea. Foreigners investing in Korea and certain essential specialists (executives, senior management, and technical experts) must meet qualifications if they seek to obtain a D-8 visa. Visas may be issued for not more than a year at a time to persons qualified to receive a D-8 visa and their family members (F-3).

The Korean government offers a variety of benefits to foreign investors in terms of their entry and stay in Korea. Foreign investors who promote foreign investment in Korea, such as by attracting multinational companies to come to Korea, executives of multinational companies entering Korea, foreign technical experts and some others may be qualified to receive an F-5 (permanent resident) visa. The government also offers entry services dedicated to foreign investors and (unmanned) smart entry service for those qualified for a D-8 visa and their family members. It also operates a channel dedicated to giving foreign investors stay permission (KOTRA Investment Consulting Center) and also exempts foreign investors from various fees required to receive stay permission.

- **Any restrictions on remitting funds out of the jurisdictions (withholdings, etc.)?**

So long as the parent company is in compliance with the Foreign Investment Promotion Act (“FIPA”), then remittance is guaranteed for dividends and capital from the sale of shares and equity owned by the foreign investor.

If capital is remitted via bank, capital more than USD 2,000 will require submission to the head of a foreign exchange bank, certain documents providing the reason for the remittance and its amount. If capital is directly carried into Korea, capital of more than USD 10,000 must be declared with the head of the applicable Korean customs and the person carrying the capital must receive a certificate of declaration of foreign currency.

### Lee International – Firm Overview

*Lee International was founded in 1961 and has its roots in technology and cross-border transactions. The firm began as an intellectual property firm that specialized in representing foreign companies doing business in Korea. But it has grown to become a premier, full-service law firm, providing legal and business services to foreign and domestic clients, including many Fortune 100 companies, in a range of practice areas in addition to its long-standing intellectual property practice. These areas of service include advice and representation in finance, real estate, M&A, general corporate, antitrust and fair trade, health care, domestic and foreign litigation and international arbitrations, labor, tax, general commercial, sports, entertainment, customs, international trade remedies, government investigations, criminal matters and others.*

*Lee International has seasoned attorneys and boasts a team comprised of former judges (including a former Korea Supreme Court Justice), senior national prosecutors, private practice attorneys, senior foreign attorneys and former judicial law clerks. The firm also employs a prominent group of senior advisers who provide a valuable network and community of additional resources for our clients. Our senior advisers include a former Deputy Director General of the World Trade Organization, former Commissioners of the Korean Intellectual Property Office, a former Minister of Trade, Industry and Energy, a former Minister of Science and Technology, and a former National Security Advisor to the Korean President.*





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# INTERNATIONAL LAWYERS NETWORK



HELLSTRÖM

ESTABLISHING A BUSINESS ENTITY IN SWEDEN





## ESTABLISHING A BUSINESS ENTITY IN SWEDEN

### 1. DESCRIPTION OF THE TYPES OF ENTITIES AVAILABLE IN EACH JURISDICTION THROUGH WHICH TO CONDUCT BUSINESS AND MATTERS TO BE CONSIDERED WHEN CHOOSING A BUSINESS ENTITY TYPE

The most common form of business association in Sweden is a limited liability company (Sw. Aktiebolag). However, there are different types of entities available for starting up a business. In the following the different types of entities among with the advantages and disadvantages associated with them will be described.

#### Limited Liability Company

A limited liability company is a form of business enterprise in which the responsibility of the shareholders is normally limited to the capital invested in the company, i.e. the shareholders are not personally liable for the debts of the company, it is the overriding principle under Swedish law that the directors of the board and the managing director has the legal responsibility of the company and its business under the applicable laws. The share capital of a private limited liability company is optional but must be at least SEK 50 000 and the share capital of a public limited company must be at least SEK 500 000. One key advantage to a Swedish limited liability company compared to many other jurisdictions throughout Europe is that there is a possibility to have different share classes with different capital and voting powers ("A" and "B" shares). Please contact Hellström law firms contact persons for more information about this.

#### Sole Trader

If you are considering starting a small business managed by one person and on your own, a sole trader (Sw. Enskild firma) could be a suitable form of business, although not

possible in a cross-border context. As a sole trader, you are personally responsible for all the company's obligations, such as debts and agreements. No investment of capital is required.

#### Trading Partnership

If at least two natural persons or legal entities are considering starting a business together a trading partnership (Sw. Handelsbolag) is an alternative. The trading partnership is an independent tax unit but the partners are personally, jointly, and severally liable for the company's debts. No investment of capital is required

#### Limited Partnerships

A specific form of trading partnership is limited partnership (Sw. Kommanditbolag). A limited partnership must have two or more partners and at least one general partner and one limited partner. A limited liability company may be the general partner in a limited partnership. For the limited partner, no investment of capital is required. For the general partner investment of capital is required, however it can be as small as SEK 1.

### 2. BRIEF OVERVIEW OF STEPS TO INCORPORATE/CONSTITUTE EACH

#### Limited Liability Company

Firstly, it should be noted that almost all businesses that we at Hellström Law firm establishes for a client is the Aktiebolag – the Limited Liability Company. It is the predominantly way forward for all businesses in Sweden and a very flexible and well-regulated association. To form a Limited Liability Company the founders (shareholders) initially must draw up a memorandum of association and articles of association. One or more of the founders subscribe for all the shares in the



company and the shares are paid up by making a payment into the bank account of the company which corresponds to the initial share capital of the company. The board of directors (normally 1-3 persons with or without deputies) then applies for registration of the company with the Swedish Companies Registration Office, within six months of the signing of the memorandum. Shares may also be subscribed for and paid for by means of a capital contribution in kind (property other than cash). In the application, the following documents must be attached; articles of association, bank statement of the share capital, if shares have been paid for with cash, a statement from an auditor, if the shares have been paid for with assets other than cash.

**Off the shelf company:** The more common and faster way of starting up a business in Sweden in the form of limited liability company is by acquiring an already formed empty “off the shelf company”. It is an “empty” limited company ready for business after some compulsory registration changes have been made according to the required business needs.

As the founder, you must have a representative in Sweden who can accept service on behalf the company if all the members of the board of directors are residing outside of Sweden. Hellström law firm may offer this service to you.

With regards to residency but note, not citizenship, a managing director and deputy managing director of a limited company must reside within the European Economic Area (EEA).

Half of the company’s board members must also reside within the EEA and the same rule applies for the deputy board members.

A company is always legally represented by the board of directors (jointly) meaning half or

more of the directors. In addition, the managing director (if one is chosen, it is optional) has the right by law to sign the firm of the company within the day-to-day business.

For practical reasons, it is common that signatory powers are assigned to one or more individual board member that are authorized to sign for the company alone or jointly (especially if you have not registered a managing director). However, a person outside the board, usually the managing director, may also be authorized to sign for the company, alone or jointly. (If such a person will be appointed you need to provide the same information as applies for board members.)

### **Sole Trader**

It is not a requirement to register your company with the Swedish Companies Registration Office, however if you choose to do so the name of the business gain protection in Sweden. You must register your business with the Swedish Tax Agency. You need to apply for F-tax and VAT registration. If you are going to have employees, you also must register as an employer with the Swedish Tax Agency.

If you are not registered in the Swedish population register, a co-ordination number, which is an identity number, is required for being able to register as a sole trader. A co-ordination number is obtained from the Swedish Tax Agency, which you later must state in your registration application with the Swedish Tax Agency. Furthermore, you must send in a copy of your passport or other identity documentation and be over 16 years old.

If you are registered in a country outside the European Economic Area (EEA) you must appoint a manager for your business for being able to establish as a sole trader in Sweden.



Regardless of whether your business has been registered with the Swedish Companies Registration Office or not you must register the manager with the Swedish Companies Registration Office. The manager must be a resident in Sweden, have a Swedish identity number and be over 18 years old.

As a sole trader, you are the one that is authorized to sign on behalf the company.

### **Trading Partnership**

For being able to establish a trading partnership, the partners must make an agreement to jointly carry out business activities. If the agreement is in writing it must be signed by all the partners. Since it is not considered as a public document, the agreement should not be filed for registration. However, note that is not a requirement that the agreement is in writing, an oral agreement is also valid.

The trading partnership must be registered with the Swedish Companies Registration Office.

A partner that is not registered in the Swedish population register, must submit a certified copy of the passport or other official identity document with the application to be registered with the Swedish Companies Registration Office.

Each partner is authorized to sign on behalf the company unless otherwise agreed. An outside party can be appointed to sign on behalf the company, however this party cannot be registered as the only person who is authorized to sign on behalf the partnership. This means that at least one partner must always be authorized to sign on behalf the company.

As stated in the foregoing a legal entity can be a partner in a trading partnership. If the partner is a foreign legal entity more documents must

be filled to the application. That is a certificate of registration that is not older than six months and that states whom is authorized to sign on behalf the company.

### **Limited Partnership**

As applies to trading partnership, the partners that wants to establish a limited partnership must make an agreement to jointly carry out business activities. If the agreement is in writing it must be signed by all the partners. Since it is not considered as a public document, the agreement should not be filed for registration. As also applies to trading partnership it is not a requirement that the agreement is in writing, an oral agreement is also valid.

The limited partnership must be registered with the Swedish Companies Registration Office.

A partner that is not registered in the Swedish population register, must submit a certified copy of the passport or other official identity document with the application to be registered with the Swedish Companies Registration Office.

A partner can be a legal entity, and if the partner is a foreign legal entity more documents must be filled to the application. That is a certificate of registration that is not older than six months and that states whom is authorized to sign on behalf the company.

As stipulated above, there must be at least one general partner and one limited partner in a limited partnership. Regarding this it is important to be aware of that general partners have unlimited liability for the company's debts whilst the limited partners only have liability for the capital (if any) they have contributed with.

The general partner is authorized to sign on behalf the company. If there is more than one



general partner, each partner is authorized to sign on behalf the company unless otherwise agreed. A limited partner is not authorized to sign on behalf the company.

As what also applies to trading partnerships, an outside party can be appointed to sign on behalf the company, however this party cannot be registered as the only person who is authorized to sign on behalf the company.

### 3. GOVERNANCE, REGULATION AND ONGOING MAINTENANCE

#### 3.1 Brief summary of regulation of each type and ongoing maintenance, reporting requirements

##### **Private Limited Liability Companies**

Shareholder's rights are exercised at the general meeting (ordinary or extra general meetings), the supreme governing body of the company. The board of directors is responsible for the organization and management of the company. The managing director (if one is appointed) is responsible for the day to day management of the company. It is the board of directors that convene the general meetings.

Companies of a certain size must appoint an approved accountant (this applies to rather small companies). Some large companies must appoint an authorized public accountant.

##### **Public Limited Liability Companies**

In addition to what is stated about private limited liability companies, public limited companies must appoint an authorized public accountant.

#### **Trading Partnerships and Limited Partnerships**

Trading partnerships and limited partnerships are governed and managed by the partners based on the agreement to jointly carry out business activities and other agreements they make in between themselves.

#### **Reporting Requirements**

Limited liability companies, trading partnerships, and limited partnerships that perform business activities in Sweden must maintain accounting records according to the Swedish Accounting Act and in accordance with the Swedish Bookkeeping Act. Annual reports consisting of a profit and loss account, a balance sheet, notes on the accounts and a directors' report must be filed with the Swedish Companies Registration Office within eleven months of the end of the financial year or the company may be liquidated. Failure to submit the annual report within seven months from the end of the financial year may result in a fine.

#### 3.2 Requirements for local shareholding/directors

##### **Private Limited Liability Companies**

There are no restrictions to what nationality a shareholder may be of or to the number of shareholders.

It is a requirement for a private limited liability company to have a board of directors.

A board of directors may consist of one or more directors. The number, or the lowest and highest number, of directors making up the board shall be regulated in the articles of association. If the board consists of fewer than three ordinary directors, at least one deputy director shall be assigned. At least half



of the board members and at least half of the deputy members must be residents within the EEA.

If the board has more than one ordinary director, a chairman of the board must be designated.

A managing director may be appointed. The managing director is normally not a member of the board of directors, however it is possible. The principal rule is that the managing director must be domiciled within the EEA. However, there is a possibility to be granted an exemption by the Swedish Companies Registration Office. The managing director is responsible for the day to day management of the company. If a managing director is appointed, he has authority to sign for the company in day-to day matters given by law.

Detailed rules regarding requirements for the appointment of board members and the managing director as well as rules relating to the responsibilities of these, terms of office and the remuneration of board members can be found in the Swedish Companies Act (2005:551) (Sw. Aktiebolagslagen).

### **Public Limited Liability Companies**

A Public Limited Liability Company is used for listed companies and companies who want to offer their shares to a wider public. The board of directors in a public limited liability company must consist of at least three members.

Public limited liability companies must appoint a managing director. The chairman of the board must not be the managing director of the company.

Specific rules relating to the board of directors and managing director of public

limited liability companies can be found in the Swedish Companies Act (2005:551).

### **Trading Partnership and Limited Partnership**

Trading partnerships are managed by the partners to it. The partnership agreement sets the limits for the management of the company. There is no legal requirement for trading partnerships to have a board of directors.

It is the partners who represent the company and act for it.

Every partner can act in the day to day management of the company unless another partner prohibits it. If any measure departs from the purpose of the company, set up in the partnership agreement, all the partners must agree on it.

Detailed rules regarding the partnerships management can be found in the Swedish Partnership and Non-Registered Partnership Act (1980:112).

Limited partnerships are managed by the partners to it, as is the case for unlimited trading partnerships. However, the general partner represents the partnership.

Detailed rules regarding the partnerships management can be found in the Swedish Partnership and Non-Registered Partnership Act (1980:112).

### **3.3 Minority shareholders' rights and protection**

#### **Private/Public Limited Liability Companies**

The basic principle is that company decisions are made by a majority vote. There are however a set of rules protecting the rights of minority shareholders.

The fundamental principle as stated in the Swedish Companies Act (2005:551) is that all shareholders must be treated equally. This is





supplemented by several rules protecting minority shareholder's rights. These include, among others which may provide protection for a shareholder, the following rights.

- Amendments to the articles of association requires support from at least two thirds of the votes cast and shares represented at a general meeting. In some cases, support is required by nine tenths of the shareholders represented.
- Acts that grant improper benefits to a shareholder or a third party to the detriment of the company or any another shareholder may not be resolved or performed by the shareholder's meeting or the board.
- Shareholders representing at least one tenth of the total numbers of shares in a company may require notice of an extraordinary general meeting.
- Under some circumstances, if a shareholder has abused his influence in the company, a court may on application by the owners of one tenth of all shares order that the company go into liquidation.
- A shareholder may be liable for damages caused to the company, a shareholder, or any other person under some circumstances.
- If shareholders representing at least one tenth of the total number of shares in the company supports a proposal for a minority auditor at a general meeting and any shareholder asks the Swedish companies Registration Office to appoint one, they must do so.

### **Trading Partnerships and Limited partnerships**

As stated above, trading partnerships and limited partnerships are managed by the partners to it. Measures undertaken regarding the company management requires the consent of all partners. If the partners have agreed that management measures may be undertaken without the consent of the other partners, it may still not be allowed in case one partner prohibits it.

If any partner decides to transfer his part of the partnership without the consent of the other partners, the Swedish Partnership, and Non-Registered Partnership Act (1980:112), contains rules limiting the new partner's rights in relation to the partnership.

## **4. FOREIGN INVESTMENT, THIN CAPITALISATION, RESIDENCY AND MATERIAL VISA RESTRICTIONS**

### **4.1 Any significant barriers to entry for an offshore party**

There are no significant barriers to entry for an offshore party. Restrictions may apply to certain types of businesses.

### **4.2 Any special business or investment visa issues**

Citizens of EU and EEA countries who intend to stay in Sweden longer than three months need to be employed, self-employed, students or have sufficient means to support themselves to have the right to live and work in Sweden after the three months has passed (right of residence) without the need for a residence permit.

Swiss citizens who wish to stay in Sweden longer than three months need to obtain a residence permit.

Citizens of other countries who intend to live and work in Sweden may need to apply for a



visa. Advice should be sought regarding each specific case prior to travelling to Sweden.

**4.3 Any restrictions on remitting funds out of the jurisdictions (withholdings, etc.)**

Dividend payments beneficially owned by non-residents are liable to a 30 % non-resident withholding tax. However, depending upon the customer's residency, it may be possible to reduce the rate of tax payable in accordance with the provisions of a double taxation treaty. Some approved international organizations may benefit exemptions from withholding tax

on dividend payments in accordance with special Swedish legislation.



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# INTERNATIONAL LAWYERS NETWORK



**DEJ-UDOM & ASSOCIATES LTD.  
ESTABLISHING A BUSINESS ENTITY IN  
THAILAND**



## ESTABLISHING A BUSINESS ENTITY IN THAILAND

Thailand has a civil or codified law system. The main legal codification governing commercial aspects in Thailand is prescribed under the Civil and Commercial Code (“CCC”) and other related Acts which are issued from time to time to govern specific circumstances.



The part of the CCC which refers to companies, called “Company Law” in other jurisdictions, is under Title XXII, “Partnerships and Companies” (Book III of the CCC). The CCC governs the establishment, management, shareholder and partner rights, and liquidation of partnerships and private limited companies. Public Companies are governed by the Public Limited Companies Act B.E. 2535 and the Securities and Exchange Act of the same year and its related Regulations and Announcements. Breaches of the CCC’s provisions concerning “Partnerships and Companies” may be subject to penalties under the “Act on Offence concerning Registered Partnerships, Limited Partnerships, Limited Companies, Associations and Foundation” B.E. 2499.

The following are the business entity types available in Thailand’s jurisdiction; however, a

foreigner’s ability to engage in them is regulated by the Foreign Business Act (“FBA”).

- **Sole Proprietorship** - Under the law, a person acting as a sole proprietor can engage in almost any lawful type of business with the exception of those businesses which have been otherwise regulated by the government. Taxation of a sole proprietorship business is calculated on a progressive personal tax rate.
- **Unregistered Ordinary Partnership** - An Unregistered Ordinary Partnership is when two or more persons join together to conduct business without formally registering their operation. Unregistered ordinary partnerships are taxed as natural persons, but each partner must also separately file their own personal tax return.
- **Registered Ordinary Partnership** - To form a Registered Ordinary Partnership, all particulars, including the partnership contract, capital contribution, management, and objectives, must be submitted to the Ministry of Commerce. Partner profits are subject to taxation, so profits are subject to two levels of taxation.
- **Limited Partnership** - In a limited partnership, the managing partners are jointly held personally liable for the partnership's debts and any non-managing partners are only liable for the amount of any undelivered or withdrawn capital contribution. Partner profits are subject to taxation, so profits are subject to two levels of taxation.
- **Private Limited Company** - Basically a corporation, a Private Limited Company must have a minimum of three persons join together to start a business with the capital divided into shares of equal par value. A



Private Limited Company is taxed as a juristic entity.

- **Public Limited Company** - A Public Limited Company is formed in order to offer shares to the general public and must have a minimum of 15 persons join together. A Public Limited Company is a juristic entity and taxed as one. Individual shareholders must pay tax on their earnings, and foreign corporate shareholders pay tax on all dividends.
- **Joint Venture** - In Thailand, a Joint Venture is not a legal entity under the Civil and Commercial Code. If two parties do enter into an agreement to work together as a Joint Venture, it is valid as long as it conforms to Thai laws. A Joint Venture's income is subject to corporate tax as a single entity.
- **Branch Office** - A Branch Office can only do business on behalf of a company based outside Thailand and must obtain a business license according to the FBA. However, a Branch Office can only engage in specific business activities granted under the FBA. A company must bring in a minimum capital of at least 3 million Baht; however, this is the minimum threshold and the actual amount is calculated at 25% of the average per year of three years' estimated expenditures. For tax payment, a Branch Office is treated as a juristic person.
- **Representative Office** - A Representative Office can only do business on behalf of a company based outside Thailand and must obtain a business license according to the FBA. A Representative Office cannot engage in any revenue earning activities in Thailand and pays no taxes. A company must bring in a minimum capital of at least 3 million Baht; however, this is the minimum threshold and the actual amount is calculated at 25% of

the average per year of three years' estimated expenditures.

A Private Limited Company ("PLC") is the most common type of business incorporation in Thailand and its basic characteristics are similar to those of Western corporations. A private limited company is formed by way of registration of its constitutive documents (Memorandum and Articles of Association) as well as other related applications with the Partnerships and Companies Registration Office, Department of Business Development, Ministry of Commerce. The *ultra vires* doctrine is still applicable in Thai law, so a company must specify in detail its objectives in its Memorandum of Association.

Shareholders of a PLC enjoy limited liability up to the amount of the unpaid value of shares invested in the company. This means that a shareholder will not be liable for more than their investment in the company (subject to extreme situations of piercing the corporate veil). A PLC is managed by a board of directors according to the laws and the Company's Articles of Association. Normally, the directors' liability will be limited and indemnified by the company unless otherwise prescribed in the company's Memorandum of Association or Articles of Association. Directors may be personally liable if they act beyond their powers as granted by laws or the Memorandum and Articles of Association, or are in breach of their duty of loyalty and care towards the company and its shareholders.

All shares must be subscribed to and at least 25% percent of the subscribed shares must be paid up on incorporation. Ordinary as well as preferred shares may be issued based upon the discretion of the shareholders' resolution. All shares must carry voting rights which might vary between ordinary and preferred shares. The minimum par value of a private company's shares is Baht 5 per share. Treasury shares for a private company are prohibited.





A Private Limited Company needs to maintain a minimum of three shareholders at all times.

In general, shareholders are entitled to attend any general meeting of shareholders and vote based upon the voting system of such entity. Minority shareholders have no absolute power to control the majority shareholders. However, the Thai Civil and Commercial Code sets some rights and protections for minority shareholders as follows:

- (i) Shareholders holding not less than one-fifth of the shares of the company may request in writing that the board call for a shareholders meeting to discuss any matter requested by such minority shareholders.
- (ii) In case the company refuses to claim against a director for compensation for injury caused by him/her, any shareholder shall be entitled to claim against the director.
- (iii) Shareholders holding not less than one-fifth of the issued shares may request the competent officer to appoint an inspector, designated by the Ministry of Commerce, to examine the affairs of a limited company.
- (iv) Any shareholder shall be entitled to request the court to cancel any resolution passed at any general meeting of shareholders if such meeting was held in conflict with the law or the company's Articles of Association.

**Annual Filing:** Upon incorporation, a PLC is granted a Tax Payer ID number, the same number as its Company Registration number. A PLC is obliged to pay corporate income tax on its annual profit to the Thai Revenue Department within 150 days from the date of fiscal year's end. A company's board of directors is also obliged to close the company's books of accounts at the end of every fiscal year and have them audited by a qualified local auditor. The audited financial statements must be submitted to the

shareholders at the annual ordinary meeting for approval within four months from the fiscal year-end. The company is obliged to submit the audited financial statement which was approved by the shareholders to the Department of Business Development within one month from the date of shareholders meeting.

**Tax Filings:** A PLC carrying on business in Thailand must file a half-year and an annual corporate income tax return. The tax paid at the half-year is a prepayment calculated on the forecasted net profit for the year and is credited against the full-year tax liability. The latest a half-year return can be filed is two months from the last day of the first six months of the company's accounting period, and the annual return must be filed within 150 days from the last day of the accounting period.

**Social Securities Fund:** Thailand also implements a social securities fund for all business entities to participate in and contribute their support to their employees. There are penalties for any non-compliance by an employer.

**Remitting funds out of the country:** All foreign exchange transactions must be done through commercial banks or authorized non-banks. Both direct and portfolio foreign inbound investments are freely permitted. Repatriation of investment funds and repayment of overseas borrowing in foreign currency can be remitted freely upon submission of supporting evidences.

**Legal Capacity and Limitation:** Limitations for undertaking business operations in Thailand will depend upon the type of business transaction and the qualifications of an operator wishing to conduct such business. In principal, **Thai** operators, whether individuals or juristic entities, can conduct all kinds of legal businesses in Thailand, unless a specific law requires certain prior qualifications and specific approvals.

The main legislation concerning **foreigners** who wish to operate a business in Thailand is the 1999



Foreign Business Operation Act (“FBA”). The FBA lists the restrictions on the type of business a foreigner can conduct in Thailand as an individual, as a juristic entity registered overseas, or as a juristic entity registered under Thai law with 50% or more of its shares are owned by foreigners, unless a specific business operation license has been obtained when applicable.

The FBA’s three Annexes contain three (3) categories of such restricted activities. Mainly, Annex 1: media, rice farming, forestry and herbs - be restricted from foreigners; Annex 2: national safety or security, arts and culture, natural resources - subject to permission of the Minister of Commerce and the Cabinet; and Annex 3 (the most common case): Services: accounting and legal services, construction, agency, auction, hotels, wholesale and retail - subject to a business license.

Despite the above-mentioned restrictions, foreigners may still obtain certain privileges for conducting restricted businesses without obtaining a business operation license (but rather merely a business certificate), as follows:

- (i) Being granted a business certificate under the Treaty of Amity and Economic Relations between Thailand and U.S.A. except for the following restricted businesses: a) communications; b) transport; c) fiduciary functions; d) banking; e) exploitation of land and natural resources; f) domestic trade in indigenous agricultural products (Remark: the said Treaty of Amity actually expired but since the FTA between Thailand and U.S.A. has not yet been finalized, the Thai Authority still grants business privilege to U.S.A. nationals and corporations);
- (ii) Being granted an investment promotion from the Thailand Board of Investment (“BOI”), and on certain occasions, the Industrial Estate Authority of Thailand (“IEAT”). For your information, the BOI is a

government entity which grants support to investors (regardless of their nationalities) which wish to conduct businesses under the promoted businesses governed by BOI. Although there are no clear thin capitalization rules in Thailand, the BOI may prescribe a maximum ratio of equity: debt. You can visit the BOI's website to obtain more details at: <http://www.boi.go.th>

In addition, please note that foreigners wishing to reside and work in Thailand will need both a non-immigrant visa and a work permit. A non-immigrant visa is initially valid for 90 days and can be extended for one year and is renewable. The procedures to acquire a non-immigrant visa are linked to procedures to obtain a work permit from the Department of Employment, Ministry of Labour.

### **Guidelines for Incorporating a Thai Limited Company**

#### **i) Corporate name reservation**

A promoter of a company is required to apply for the company’s name reservation, either directly or electronically, with the Registrar’s Office at the Department of Business Development, Ministry of Commerce. The result is obtained on the date of filing.

#### **ii) Incorporation**

Thereafter, the process for incorporation consists of two steps, namely:

#### **Step 1. Registration of the Memorandum of Association**

Information required for this registration includes:

- (i) Corporate Title
- (ii) The Location of the Company’s Head Office
- (iii) The Company’s Objectives



- (iv) Registered Capital: There is no minimum requirement set by the Registrar. Therefore, the business owner needs to consider the size of its business. According to Thai law, the par value of shares of a company must not be less than Baht 5 each.
- (v) Name of Promoters: Under Thai law, three individual promoters need to enter their names and subscribe for at least one share of the Company.

**Note:** The Promoters shall affix the Revenue Stamp of Baht 200 on the original copy of Memorandum of Association prior to filing the same with the authority.

Generally, the registration process for the Memorandum of Association takes two to three days, but it depends on the completeness of the application. Once approved, the registration fee must be paid to the Registrar's Office. The government fee is collected at a rate of Baht 50 for each Baht 100,000 registered capital with a minimum amount of not less than Baht 500 and a maximum amount not exceeding Baht 25,000.

#### Notice Calling for Statutory Meeting

After registration of the Memorandum of Association, the authorized promoter will issue a notice calling for a Statutory Meeting. The said meeting must be scheduled no less than seven days from the date of issuing the notice, which normally is the day after the Registration of the Memorandum of Association.

#### Statutory Meeting

At the Statutory Meeting, the Chairman will be elected and the Agenda contained in the Notice calling for the Statutory Meeting shall be discussed. There are altogether six matters that need to be considered at the Statutory Meeting, as follows:

- (1) Approval of the first list of shareholders.

- (2) Ratification of actions taken and approval of expenses incurred by the promoters of the company in the process of formation, if any.
- (3) Approval of the Company's Articles of Association.
- (4) Appointment of the Company's Board of Directors and fixing the authority of the authorized directors of the Company.
- (5) Appointment of the Company's auditor and approval of his/her remuneration.
- (6) Other businesses, if any.

#### Notes:

- (1) The director shall affix the Revenue Stamp of Baht 200 on the original copy of Articles of Association ("By-Laws") prior to submitting the same to the authority.
- (2) According to Thai law, a Company is not required to have a corporate seal. In practice, a Thai company usually has a corporate seal to prevent fraudulent acts by unrelated persons.

#### Shareholders

Thai corporate law requires a minimum of three shareholders of the Company at all times.

#### Important Note:

According to new registration criteria:

- (i) Proof of Actual Investment in a new company
  - A company with **more than 5 Million Baht** registered capital is required to **prove** the payments of shares made by the shareholders. For incorporation, the authorized director must collect all shares payments and **deposit** same first into his/her personal bank account in Thailand + obtain a confirmation letter issued by such bank confirming the outstanding amount that was deposited into such bank



- account accordingly. This bank letter will be part of documents for registration.
- Once the Registrar approves the incorporation, the Board has the duty to further adopt a resolution for opening a bank account and the related director shall **transfer** such shares capital into the Company's bank account ASAP. Then (in the same manner as above), a Bank confirmation letter from the Company's bank is to also be submitted to the DBD to prove the outstanding balance amount that was deposited into the Company's bank. This step must be completed within 15 days from incorporation. Failure to do so will blacklist (DBD-wise) the company.
  - The above process is **exempted** if all board members are foreigners (as they may not be able to practically open a personal bank account in Thailand), so submitting a clarification letter to the Registrar informing that there is no such bank account in Thailand, would be sufficient instead.
  - However, the Company still has the duty to open a bank account for depositing the shares payments and submit the Bank's Confirmation letter (where the Company will open its account) to the DBD **within 15 days from incorporation date**.
- (ii) Proof of Actual Investment in a new company by any Thai shareholders
- In a case of a company with foreign shareholders that are holding less than 50% of the total registered capital, the Thai shareholder(s) must submit his/her bank confirmation letter confirming the outstanding balance in his/her bank account to prove his/her financial ability for such investment.

- o The same rule applies for a company that has no foreign shareholders but has a foreign authorized director as one of its board members.

## Step 2. Final Registration

After the Statutory Meeting, all directors appointed in the meeting must sign the application form and other related documents needed to register the Company as required by Thai Corporate Law. The application form shall be accompanied with copies of the Memorandum and Articles of Association and details concerning office address, names of directors and authorized directors, name of auditor, etc. Once approved, the registration fee must be paid to the Registrar's Office at Baht 500 for each Baht 100,000 of registered capital with a minimum amount not less than Baht 5,000 and a maximum amount not exceeding Baht 250,000.

**Remark:** According to the amendment of the Thai Civil and Commercial Code effective on July 1, 2008, the registration incorporation process for a company can be completed with the Department of Business Development within one day.

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*Dej-Udom & Associates, an independent law firm in Bangkok, Thailand, provides legal services to a diverse client base that ranges from leading multinational corporations to local companies and individuals. The firm supplies partner-led service in the practice areas of Litigation, Immigration & Employment, Intellectual Property, Corporate Law and Services, Taxation, and Financial Markets and Investment to clients who value expert counsel and astute representation coupled with realistic billing policies and personal contact and attention. The Corporate Department is a one-stop corporate solution for all business types and represents multinational corporations, small & medium-sized enterprises, local companies, and Thai and foreign small businesses. The firm's corporate practice handles the formation of all kinds of juristic entities including, but not limited to, public limited companies, limited liability companies, joint ventures, consortiums, and branch and regional offices. Other matters covered include reorganizations and restructurings, investments, mergers and acquisitions, due diligences along with obtaining special benefit privileges and incentives from government agencies including the Thailand Board of Investment (BOI) and Industrial*



*Estate Authority of Thailand (IEAT). This department also advises on and drafts contracts and other business and legal documents and offers full corporate secretary services. The Corporate team combines transactional expertise with comprehensive experience*

*in all areas of law relevant to establishing and operating a business in Thailand and regularly handles a wide range of complex domestic and cross-border corporate and commercial matters.*





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# INTERNATIONAL LAWYERS NETWORK



**ÖZCAN & NATAN ATTORNEY PARTNERSHIP  
ESTABLISHING A BUSINESS ENTITY IN TURKEY**



## ESTABLISHING A BUSINESS ENTITY IN TURKEY

### A. Types of Business Entities

#### 1. Description of The Types of Entities

Pursuant to Turkish Foreign Direct Investment Law, foreign investors are free to make foreign direct investments in Turkey and shall be subject to equal treatment with domestic investors. Thus, foreign invested companies enjoy the same rights available to local companies under the Turkish Commercial Code (“TCC”). The TCC provides several company structures. However, largely due to advantages regarding liabilities borne by the shareholders, investors most commonly chose between a stock corporation known as *anonim sirket* which is similar to an *Aktiengesellschaft* under German law and to a *société anonyme* under Swiss or French law and limited liability company known as *limited sirket* which resembles a *GmbH* under German



law or an *S.A.R.L.* under French law.

#### 2. Matters to Be Considered When Choosing Between *Anonim Sirket* and *Limited Sirket*

- Both companies can be established with one or more shareholders.
- Both companies, in theory, are solely liable for their debts and liabilities with their assets. However, shareholders and directors of a *limited*

*sirket* are responsible with their personal assets for the tax liabilities and social security contributions which may not be collected from the company. On the other hand, shareholders of an *anonim sirket* who are not board members do not have such responsibility. According to article 553 of the TCC, board members may only be held liable for damages if they breach any obligation imposed on them by law or the articles of association of the company and if their fault or negligence caused the damage.

- The *anonim sirket* shares are usually freely negotiable instruments; therefore, share transfers are not subject to notarization and registration. On the other hand, any share transfer in a limited sirket requires fulfillments of execution of share transfer agreement before a Notary Public, approval of general assembly of shareholders and registration with the Trade Registry.
- The share transfer of a limited sirket is subject to income tax for the selling party. However, in an *anonim sirket*, if share certificates are held more than two years by the selling party, the share transfer will not be subject to income tax.
- *Limited sirket* is a simpler form of corporate ownership. There is no compulsory board of directors. The company’s business may be managed directly by the shareholders. It is possible to appoint one or more managing directors.
- It is statutory to establish companies operating in certain fields such as banks and insurance companies shall



be established as *anonim sirket*.

## B. Steps and Timing to Establish

Although the required documents for establishing the above described companies are almost the same, it differs in accordance with either preferred type or way of participation to the partnership. Common basic steps are as follows:

- Before the incorporation of a company, shareholders should register with the local tax office and receive potential Turkish Tax Identification Number.
- All the required documents and statements such as articles of incorporation certified by notary public, signature declarations and chamber registration statement should be submitted to the Trade Registry Office located at the province where the company will be established.
- The documents delivered to Trade Registry Offices should get the official approval after their examination of whether all given and described conditions on the documents and statements are in compliance with legislation.
- Company registrations should be announced to third parties or related parties through being published on Turkish Commercial Registry Gazette.

After all required documents are prepared; the incorporation process of the company normally does not take more than a week.

## C. Governance, Regulation and Ongoing Maintenance

### 1. Brief Summary of Regulation of Each Type and Ongoing Maintenance, Reporting Requirements

#### i. *brief summary of regulation of anonim sirket and limited sirket*

*Anonim sirket* is managed by its board of directors. The board of directors may be comprised of a single person or more. Non-shareholders and legal entity shareholders can be appointed as board members.

*Limited sirket* may be governed by one or more managers. The shareholders can transfer their management rights to one or more shareholders or can appoint third party manager(s) provided that at least one of the managers is a shareholder.

#### ii. *reporting requirements*

The board of directors of *anonim sirket* should prepare financial statements, its supplement annual report while the manager of *limited sirket* should prepare financial statements, annual activity reports.

It is compulsory to appoint independent auditor(s) for the type companies determined by the TCC and shall prepare reports for risk detection and risk management.

### 2. Requirements for Local Shareholding/Directors

*Anonim sirket* and *limited sirket* can be established with 100% foreign capital without the necessity of a Turkish shareholder and at least one



shareholder is required for the incorporation. Shareholders may be natural persons or legal entities, residents or non-residents in Turkey. In both corporate forms, there is no obligation for directors and managers to reside in Turkey or to be Turkish citizen.

### 3. Minority Shareholders' Rights and Protection

Minority shareholders' rights are regulated under the TCC. Minority shareholders have right to request the followings:

- extraordinary general assembly meeting to be convened, or that a time to the agenda of the general assembly meeting to be added,
- postponement of balance sheet discussions for one month to have a chance to review the balance sheet in detail,
- independent auditor to be appointed or replaced,
- under circumstances requesting dissolution of the *anonim şirket* by filing a lawsuit,

Minority shareholders may also be granted the right of being represented in the board of directors by the articles of association. Apart from the rights mentioned above, meeting and decision quorum also have impact on minority rights. For instance, consents of at least 75% of shareholders of *anonim şirket* are required to change the scope of the company.

### D. Foreign Investment, Thin Capitalization, Residency and Material Visa Restrictions

#### • Barriers to Entry for An Offshore Party

All the procedures for incorporating foreign invested companies are the same as local companies. The national treatment principle is applicable by all means. Therefore, there are not significant barriers to entry for an offshore party.

#### • Thin Capitalization

According to Corporate Income Tax Law, if the total of the borrowings of a corporation, which are obtained directly or indirectly from its shareholders or persons related to the shareholders and used in the business, exceeds three times of the equity capital of the corporation at any time within the fiscal year, the excess part of the borrowings will be considered as thin capital for the relevant fiscal year. However, borrowings such as loans borrowed by the banks or from third parties based on non-cash guarantees provided by the shareholders or persons related to the shareholders are not deemed to be thin capital.

#### • Capitalization Obligation

Incorporation of a company requires the minimum capital as stipulated in the TCC. Accordingly, the minimum capital amounts required for an *anonim şirket* is TL 50,000 (approx. EUR 18,500) while TL 10,000 (approx. EUR 3,600) for a *limited şirket*. For both companies, if the shares are stipulated in cash, at least 25% of the capital should be paid during the registration process and the unpaid



amount should be paid within 24 months after registration. Assets including intellectual property rights may be contributed as capital in-kind provided that those assets are transferable and eligible for valuation in cash.

mentioned incomes utilized within Turkey will be subject to withholding tax.

- **Special Business or Investment Visa Issues**

Due to the national treatment principle, foreign investments are not subject to pre-entry screening requirement or additional approvals and authorizations. However, the companies operating in certain commercial activities determined by the TCC should obtain permission from the General Directorate of Domestic Trade for the incorporation of company such as banks, private finance institutions, insurance companies, financial leasing companies, factoring companies, holding companies, companies operating as foreign currency exchange offices, companies dealing with public warehousing, publicly held companies subject to the Capital Markets Law, companies that are founders and operators of free zones.

- **Restrictions on Remitting Funds Out of The Jurisdictions**

Pursuant to Turkish Foreign Direct Investment Law, investors can freely transfer abroad: net profits, dividends, proceeds from the sale or liquidation of all or any part of an investment, compensation payments, amounts arising from license, management and similar agreements, and reimbursements and interest payments arising from foreign loans through banks or special financial institutions. All





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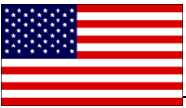


# INTERNATIONAL LAWYERS NETWORK



CONNOLLY GALLAGHER LLP, DAVIS MALM &  
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ESTABLISHING A BUSINESS ENTITY IN THE UNITED  
STATES

ILN CORPORATE GROUP



## ESTABLISHING A BUSINESS ENTITY IN THE UNITED STATES

### 1. Choosing the Right Legal Structure

#### 1.1 Introduction

Establishing a business entity in the United States can be an important strategic step for any international company that wants to avail itself of the world's economy. There are, however, many considerations to weigh carefully in consultation with an experienced attorney. Perhaps first and foremost, a company should choose the legal structure that is most advantageous and best suited to their needs. Section 1 examines the basic principles of five of the most common types of business entities in the United States: the corporation, the limited liability company, the general partnership, the limited partnership, and the limited liability partnership. In particular, this Section will highlight governance, capitalization, personal liability, and tax treatment for each entity type. While the tax discussion will focus on federal income tax, most state laws follow federal income tax principles. Finally, some consideration will be given to less-common business structures and other regulatory issues.

#### 1.2 A Preliminary Note: Choosing a State for Organizing the Entity

In the U.S. federal system, each state promulgates its own statutes and regulations that govern the business entities which may be established in that jurisdiction. It is important to remember that in most cases there is no general "U.S. corporation," and that choosing the state in which to organize is a preliminary decision that will affect a company's formation requirements and operations. A natural choice for local companies is often the state where the company maintains its primary place of business or U.S. headquarters.

Nevertheless, a company domiciled in the U.S. can be organized in any state and Delaware is the most popular state for domestic and international companies alike. Delaware's Court of Chancery has extensive experience interpreting business legal documents and adjudicating disputes, and all cases are decided by judges. This lends a certain predictability that many businesses find desirable. In addition, the comparative speed at which the Delaware courts resolve those disputes is an attractive feature to many, and the Delaware Rapid Arbitration Act enacted in 2015 allows for even quicker resolution of disputes to those who choose that route. Many other states, however, are popular for a variety of reasons: New York, Maryland, and Nevada to name a few. This article will provide general principles, but will focus on Delaware law when referring to specific state laws or interpretations of state laws. Regardless of a company's chosen state, it may have to register as a "foreign" company in other states where it conducts business, may be subject to special fees or franchise taxes in those states, and may, in certain cases, be subject to restrictions imposed by local corporate statutes even though it is formed in Delaware.

#### 1.3 The Corporation

The corporation has traditionally been the most popular form of business entity in the United States. Once formed under state law, corporations are often described as being "public" or "private," depending upon whether their shares are registered with the United States Securities and Exchange Commission and therefore freely tradable by members of the public or whether, instead, each individual trade of shares must be separately registered or fit within



an exemption from applicable federal registration requirements. Generally, a private corporation may go public after establishing itself in the U.S. marketplace through an initial public offering (“IPO”), which is commonly undertaken to provide access to capital markets.

**Governance:** A corporation is owned by its stockholders, each of whom holds a certain number of shares representing equity ownership in the company. Management, however, is vested in a board of directors. In Delaware, a corporation may have any number of directors. The directors are not required to be United States citizens or residents. These directors owe important fiduciary duties to the corporation and its stockholders (and to creditors in an insolvency setting), and establish corporate by-laws to regulate corporate decision-making. Typically, the directors will delegate many of the day-to-day management activities to the officers of the corporation, subject to their oversight. Most corporations have at least three officers: a President (often also called the Chief Executive Officer), a Treasurer, and a Secretary, but many other officers are also often named by the Board. One person can serve in multiple roles as an officer, and a person may be both a director and officer. Officers also owe fiduciary duties and also need not be United States citizens or residents.

The fiduciary duties owed by directors and officers consist primarily of the duty of care and the duty of loyalty. The duty of care requires that the responsibilities of office be discharged in an informed and considered manner. The duty of loyalty requires that the relevant decision makers act on an independent and disinterested basis, in good faith, and in a manner that they

honestly believe to be in the best interests of the corporation and its stockholders. Unless successfully rebutted by evidence of breaches of fiduciary duties, the business judgment rule will normally apply and a Delaware court will not substitute its judgment for that of the board of directors or officers.

Stockholders are entitled to vote to elect the board of directors, to approve changes to the corporation’s “charter” or certificate of incorporation (the terms are used interchangeably), and to vote on major corporate events including a merger, a sale of all or substantially all of the corporation’s assets, or the dissolution of the corporation. Controlling stockholders owe fiduciary duties to minority stockholders.

In a closely-held corporation (a statutorily-defined type of corporation whose charter contains certain restrictions on the transfer and ownership of its shares), Delaware law allows direct management by the stockholders, so long as the corporation meets the statutory requirements for closely-held status. With the advent of the LLC (discussed later), which more readily permits management by members, closely-held corporations are pretty rare today.

**Capitalization:** A corporation will generally issue shares of common stock to its founders upon formation. Either common or preferred stock, described more fully below, may be issued to investors to raise capital. A private corporation may pay out dividends to attract stockholders, since there is no readily available market for its shares; although under Delaware law the amount of the dividend must be less than the difference between the net assets of the corporation and the aggregate par value of its outstanding stock. It may also make “capital calls” (if permitted under its



organizational documents or under a stockholder agreement) or issue additional shares (but not more than the number authorized in its charter) to raise capital. Public corporations can raise large amounts of capital via an IPO or additional public securities offerings. Dividends become less important to attract investors, because stockholders can freely trade their shares in the markets where they are listed.

Corporations may, if authorized in their certificate of incorporation, issue additional classes of stock, usually called preferred stock, that give holders additional rights – such as priority for dividends or preference in a liquidation – and may also restrict certain other rights, such as voting. Many private corporations also, or alternatively, elect to place transfer and ownership restrictions on their shares in a separate stockholders' agreement. Corporations may also raise capital by taking on debt. Many public corporations issue bonds to investors in addition to other traditional means of borrowing, while private corporations often issue preferred stock, sometimes in combination with traditional lending arrangements.

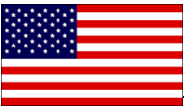
**Personal liability:** One very attractive aspect of a corporation is the limited liability of the stockholders. Generally, stockholders are exposed to liability only up to the amount of their investment in the corporation. Directors can potentially be personally liable to the stockholders for violations of certain fiduciary duties, but a corporation may include in its certificate of incorporation a provision that eliminates or limits the personal liability of directors for monetary damages for breaches of the duty of care. Moreover, many corporations carry directors and officers (D&O) liability insurance covering certain actions taken by

directors and officers and will also indemnify their directors and officers for certain non-fraudulent behavior. If a private corporation is merely an alter-ego of a single owner, courts may “pierce the corporate veil” and hold that individual liable for the corporation's debts and obligations.

**Tax treatment:** U.S. domestic corporations are subject to U.S. federal income tax on their worldwide income regardless of source, but generally may claim a foreign tax credit or deduction for taxes imposed by non-U.S. jurisdictions. For this purpose, a U.S. corporation is considered domestic if it is formed under U.S. law or the law of any U.S. state. Thus, a corporation organized under state law will be treated as domestic, and subjected to tax on its worldwide income, regardless of whether its place of management and control is outside the U.S. One potential drawback to a corporation is that it is subject to so-called “double taxation.” A U.S. corporation will pay state and federal corporate income tax on its income at the corporate level. Moreover, individual stockholders will also pay personal state and federal income tax on any income from dividends distributed.

Some corporations, if they meet the qualifications, will opt for “S-corporation” filing status (a term referring to an election to be treated as an S-corporation under federal and state tax law). All profits (and losses) “pass through” an S-corporation and individual stockholders pay tax only at the personal income level, so long as the corporation maintains its S-corporation status. To maintain such status, there can be no more than 1 class of stock (with limited exceptions) and no more than 100 stockholders, and all stockholders must be U.S. citizens and natural persons, or certain





qualified trusts. S-corporations are rarely useful in the international context.

#### **1.4 The General Partnership**

A general partnership is any association of two or more individuals or business entities who carry on a business for profit. The general partnership can be a very flexible structure, easily tailored to the needs of the partners via a partnership agreement. Moreover, general partnerships enjoy partnership taxation and are not taxed at the entity level. It is important, however, to consider some of the drawbacks of the general partnership before pursuing this type of entity.

**Governance:** A general partnership is owned and controlled by the partners, who have wide latitude to organize partnership governance in the partnership agreement. In Delaware, for example, a partnership agreement will control in almost every situation unless the agreement conflicts with explicit statutory requirements. For large partnerships, these agreements can become very complex and will occasionally result in gridlock between partners. In general, a partner is an agent of the partnership, and owes the partnership basic fiduciary duties of care and loyalty. If any partner disassociates from the partnership, the partnership will automatically dissolve unless the partnership votes to continue business.

**Capitalization:** A partnership raises capital through equity contributions by the partners and by taking on debt. Partners may also be able to transfer their economic interest in the partnership to an outside party, such as a creditor, but with few exceptions partnership interests are not publicly-traded in capital markets.

**Personal liability:** The major drawback to a general partnership is that each partner is jointly and severally liable for the obligations of the partnership. The only exception to this rule is if a partner joins a partnership after the obligation was incurred by the partnership.

**Tax treatment:** The partnership pays no income tax as an entity. Instead, partners pay individual income tax after partnership income is deemed distributed to the partners. This is known as “pass-through” taxation, and is one of the most desirable aspects of forming a partnership. However, in the international context this is often a distinct problem, because non-United States partners will be required to file United States tax returns and pay taxes to the United States. In addition, foreign corporations that invest in a partnership may be subject to a 30% branch profits tax on their accumulated earnings and profits effectively connected to a U.S. trade or business carried on by the partnership. For this reason, non-United States investors in partnerships (as well as LLCs, discussed below) often hold their interests through “blocker” companies formed in off-shore jurisdictions. This permits these investors to obtain the benefits of pass-through taxation without subjecting the foreign investor to United States filing, tax and audit requirements that may reach all of their worldwide activities.

#### **1.5 The Limited Liability Company (“LLC”)**

The LLC is a relatively new and increasingly popular choice of business entity. Nowadays, a substantial majority of new entities formed in Delaware are LLCs. Members of the LLC benefit from limited liability, pass-through taxation, and a highly-customizable management framework. Nevertheless, because LLCs are so new





(having first been introduced in 1993), the case law is still not quite as developed as it is for corporations, although that is rapidly changing given the popularity of LLCs. Moreover, LLCs usually lack access to capital markets that public corporations enjoy, and while some LLCs have been brought public there remains a clear preference in the investment community for corporations as the IPO vehicle.

**Governance:** The owners of an LLC are called “members.” Members may manage the LLC themselves, or set up a wide variety of management frameworks using the LLC agreement, including a board of “managers” that functions much the same as a board of directors in a corporation. LLCs also may, but are not required to, name officers. LLCs are creatures of contract, and state laws typically give wide discretion to LLC agreement governance. In Delaware, for example, the LLC agreement will control over nearly any default statutory management rule. In the absence of any provision in the LLC agreement, corporate style fiduciary duties will apply. The LLC agreement can eliminate, limit or expand those duties but cannot eliminate the implied covenant of good faith and fair dealing. Like partnerships, LLC agreements can become very complex and will occasionally result in gridlock between members. Unlike partnerships, LLCs can also be wholly-owned by one member (a natural person or another entity) who exercises complete control of the LLC.

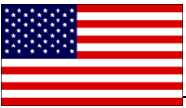
Since 1996, Delaware has permitted “series LLCs,” which allows an LLC to be subdivided into separate series of “members, managers or limited liability company interests...” with separate rights, powers, or duties with respect to specific property or obligations of the LLC, or with respect to profits and losses

associated with specific property or obligations. The debts and other liabilities of a separate series will be enforceable against only that series. Prior to the advent of the series LLC, achieving that same benefit would have required the formation of separate LLCs to hold separate assets or activities.

**Capitalization:** LLCs can raise capital by issuing equity interests to new members or by taking on debt. The LLC agreement offers a great deal of flexibility – members regulate how and when new equity may be issued, and can create different classes of membership that offer varying levels of voting rights, powers, distribution rights, and duties. Unless prohibited under the LLC agreement, members can also assign or pledge their equity stake in an LLC to a third party. Depending on the terms of the LLC agreement, this assignment can include both the financial interest and membership rights and powers. Subject to a few restrictions under state and federal tax law, profits and losses may be allocated among the members as provided in the LLC agreement.

**Personal liability:** Similar to a corporation, the debts, obligations, and liabilities of an LLC are solely those of the LLC and no member will be held personally liable for those debts, obligations, and liabilities. This limits the exposure of most LLC members to the amount of their equity contribution, and is a significant advantage LLCs have over general partnerships. Most state courts, including Delaware, have applied the same principles for “piercing the veil” to LLCs as they have to corporations.

**Tax treatment:** An LLC with multiple members is treated as a partnership for tax purposes, enjoying pass through taxation, unless the LLC otherwise elects corporate



tax treatment. Please see the discussion of partnership tax treatment above for important tax information on the taxation of non-United States investors in partnerships. If the LLC meets the necessary requirements, it may opt for S-Corporation tax status, which, although very similar, is slightly different in treatment than partnership taxation and may be more favorable to the members. A single-member LLC is treated as a disregarded entity for income tax purposes unless it elects to be taxed as a corporation. Like foreign corporations that invest directly in partnerships, foreign corporations that invest in a single member LLC treated as a disregarded entity may be subject to a 30% branch profits tax on their accumulated earnings and profits effectively connected to a U.S. trade or business carried on through the disregarded entity.

The Internal Revenue Service generally treats each series within a series LLC as a separate and distinct entity.

### **1.6 The Limited Partnership (“LP”)**

An LP offers many of the advantages of a general partnership, but also allows for a class of “limited partners” who contribute capital to the partnership, but do not face the joint and several liability of general partners. This entity is attractive because of its ability to attract investors who would be unwilling to join as a general partner. Like a general partnership, limited partnership interests are rarely publicly traded.

**Governance:** In an LP, only general partners may manage the partnership. For example, under Delaware law, a limited partner may not participate in the control of the business. They may, however, vote on certain issues that affect the partnership, such as dissolution, admission or removal of

partners, or an amendment to the partnership agreement. Like a general partnership and an LLC, the partners in an LP can tailor the structure of management to their needs in a variety of ways using a partnership agreement.

**Capitalization:** An LP can more easily raise additional capital than a general partnership by creating and offering limited partnership stakes. These are attractive to potential investors because limited partners do not assume joint and several liability for the debts or obligations of the partnership.

**Personal liability:** An LP must have at least one general partner (a natural person or an entity) who is jointly and severally liable for the debts and obligations of the partnership. Limited partners – so long as they do not participate in control – are not liable for the partnership’s debts. Moreover, a limited partner who does participate in the control of the business is only liable to persons who transact business with the limited partner and reasonably believe the limited partner to be a general partner.

**Tax treatment:** A limited partnership enjoys partnership pass-through taxation treatment. Please see the discussion of partnership tax treatment above for a description of this treatment.

### **1.7 The Limited Liability Partnership (“LLP”)**

Like the LLC, the LLP is a relatively recent hybrid creation that combines the limited liability of a corporation with the tax advantages of a partnership. The LLP is, for all practical purposes, a general partnership, except that the debts and obligations of the LLP are solely those of the partnership. An LLP faces additional administrative and filing requirements as trade-offs for this advantage.



**Governance:** Like a general partnership, the partners manage and control the partnership. They establish the management framework through a partnership agreement that is flexibly drafted to address the partnership's needs.

**Capitalization:** An LLP raises capital like a general partnership. The partnership agreement may create different classes of partnership interests, with different rights and powers, to attract different classes of investors.

**Personal liability:** Debts and obligations arising out of an LLP are solely those of the partnership.

**Tax treatment:** The LLP enjoys partnership pass-through taxation treatment. Please see the discussion of partnership tax treatment above for a description of this treatment.

### **1.8 Banks, Joint Ventures and Special Entities**

**Banks:** It is important to understand that none of the entities described above are appropriate for a company that will conduct commercial banking activities, such as receiving deposits or certain trust activities. In the United States, all commercial banks must be chartered by either an individual state or the federal government (a "national association"). Both state and national banks are subject to significant regulation and oversight, and any foreign bank moving a bank or branch to the United States, starting a new bank, or acquiring an existing bank should consult the advice of an attorney experienced with bank regulations. Formation often involves establishing a bank holding company and a formal charter approval process. Although state and national commercial banks are subject to strict oversight, they do enjoy many privileges, such as deposit insurance from

the Federal Deposit Insurance Corporation and discounted loans from the Federal Reserve.

**Joint Ventures:** A joint venture entails a formal collaboration between two separate business entities. Entering a joint venture with an established U.S. company may be an ideal arrangement for a foreign business. Joint ventures can take the form of any of the business entities discussed above, or may simply be a contractual agreement. Regardless of the form, joint ventures should be custom tailored to the needs of both entities and formed after close consultation between the venturing parties and their respective legal counsel.

**Real Estate Investments:** Sales of U.S. real property interests ("USRPIs") are subject to special income tax rules under the Foreign Investment in U.S. Real Property Tax Act ("FIRPTA"). Sales of USRPIs by non-U.S. investors are subject to U.S. federal income tax. To ensure the tax is paid, a purchaser is generally required to withhold 10% of the purchase price and the non-U.S. seller is required to file a U.S. tax return to claim a refund of any amounts withheld in excess of the actual tax due. The sale of stock in a U.S. domestic corporation is treated as a USRPI if the corporation is a U.S. real property holding corporation ("USRPHC"). In general, a U.S. domestic corporation is a USRPHC if the fair market value of USRPIs held by the corporation equals or exceeds 50% of the fair market value of its USRPIs and its interest in real property located outside the U.S., plus any other of its assets which are used or held for use in a trade or business.

**Real Estate Investment Trusts:** The U.S. provides special tax benefits for corporations that qualify as real estate investment trusts ("REITs"). REITs must



satisfy strict and detailed requirements intended to ensure that their activities are primarily limited to passive investments in professionally managed real estate investments. REITs pay corporate tax only on amounts not distributed to their stockholders. To the extent that a REIT distributes its income to its stockholders, therefore, its income is subject to a single layer of tax at the stockholder level. In this respect, REITs resemble pass thru entities such as partnerships. Because REITs are treated as corporations, however, non-U.S. investors in a REIT generally are shielded from most U.S. tax and reporting requirements.

**Statutory Trusts:** Trust relationships have existed under common law for centuries, with courts allowing property ownership to be divided such that a fiduciary would hold legal title to property on behalf of another. Such common law trusts are not legal entities but rather simply contractual fiduciary relationships between a trustee and a beneficiary. In contrast, the Delaware Statutory Trust Act expressly designates trusts formed thereunder (“DSTs”) as legal entities and provides a statutory regime to govern their existence. Delaware’s law is flexible as to the operation, management and activities of the DST and the limited liability granted to beneficial owners, making DSTs a perfect vehicle for a diverse range of business transactions, but most prevalently for real estate transactions. Unlike a REIT, a beneficial interest in a DST that owns real estate assets is considered a “direct interest in real estate” for U.S. tax purposes, and, thus, can qualify as a tax-deferrable real estate investment by the beneficiary.

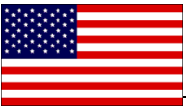
## **1.9 Regulatory Issues**

It should be noted that businesses in the United States are subject to a wide variety of regulatory schemes at both the state and federal level. For example, any company issuing equity interests (whether through private placements or public offerings) is likely subject to regulation by the Securities and Exchange Commission as well as state securities laws. Companies merging with or acquiring another company must look closely at applicable antitrust law. Any company with employees will have to consider state and federal employee protections or state workers’ compensation schemes. Moreover, companies involved in specific industries may encounter additional regulations. For example, manufacturers need to look closely at environmental regulations, communications companies must address federal communication regulatory issues, and companies engaged in providing consumer goods and services face a number of regulations designed to protect consumers. In nearly any scenario, these regulations may create extensive administrative costs, and the advice of competent legal counsel will be needed to ensure compliance with all related federal and state regulations.

## **2. Forming Your Business Entity – First Steps**

### **2.1 Introduction**

Once the organizers have decided on a particular business entity, there are still many steps to take before opening for business. In most states, a business must apply for a business license and have a registered agent in the state, and should consider reserving its name. Moreover, any business with employees must obtain a Federal Employer Identification Number from the IRS and consult with the state’s tax



regulator. In Delaware and many other states, the business entity is formed on the same day as filing so long as the filing meets all statutory requirements. Often the filing process and payment of fees may be completed online. This Section identifies the concrete first steps to forming a particular business entity. Rather than offering an exhaustive list, it highlights the key statutory requirements based on Delaware law.

## **2.2 The Corporation**

In order to form a corporation, a business must file its certificate of incorporation with the Secretary of State. The certificate must contain a variety of information, including the name, registered office address, and a general corporate purpose. Moreover, the certificate must name the incorporators and/or the initial directors. The certificate may provide that the board of directors can amend the by-laws. Stockholder approval will be required for any amendment to the certificate of incorporation after receipt of any payment for stock.

## **2.3 The General Partnership**

A general partnership is formed anytime two or more persons agree to carry-on as owners of a business for profit, and no formal state filing is required, except that many states require the filing of a fictitious name registration for the name under which the partnership is doing business. The partnership is formed whether or not these individuals intend to form the partnership. Nevertheless, a partnership may file a statement of partnership existence with the Secretary of State. Generally speaking, however, the partnership will be governed by the terms of its partnership agreement unless it

directly contradicts a mandatory statutory rule.

## **2.4 The Limited Liability Company (“LLC”)**

An LLC must file a certificate of formation with the Secretary of State. The certificate must include the name of the LLC and the name and address of the registered agent and the registered office. Members of the LLC must draft an LLC agreement that can become effective after or at the date of filing. There is no requirement to file the LLC agreement.

## **2.5 The Limited Partnership (“LP”)**

All general partners must file a certificate of limited partnership with the Secretary of State in order to form an LP. The certificate includes the following information: name of the partnership, name and address of the registered agent and office, and names and addresses of all general partners. Again, the partners should pay careful attention to the partnership agreement, which may take effect after or at the date of filing. There is no requirement to file the partnership agreement.

## **2.6 The Limited Liability Partnership (“LLP”)**

A general partnership may file a statement of qualification with the Secretary of State to become an LLP. The statement includes the name of the partnership, the name and address of the registered agent and office, the number of partners, and a statement that the partnership elects to be an LLP. Like the general partnership and LP, the LLP partners should set up their governance framework in a partnership agreement that is not required to be filed.

## **2.7 Conversion or Redomestication Merger**

Sometimes an entity that already exists in a foreign (meaning a non-Delaware)





jurisdiction may wish to become a Delaware entity. If permitted under the laws of the jurisdiction in which it currently exists, it can usually convert directly into a Delaware entity by filing of a certificate of conversion and its new certificate of incorporation / formation / etc. in Delaware. It can even change type of entity in the process, for instance by converting from a foreign corporation into a Delaware limited liability company. For purposes of Delaware law, the Delaware entity into which the foreign entity converts is the same entity as the foreign entity.

In cases where the applicable foreign law does not allow for a conversion, such law may allow for mergers. In such instances, a new entity can be formed in Delaware and the foreign entity can merge into that entity. One disadvantage of such a “redomestication merger” process as opposed to a conversion is that the Delaware entity is considered a new entity for purposes of Delaware law. This distinction may have tax effects, may necessitate the receipt of additional regulatory approvals or third-party consents, and may have other ramifications that should be carefully considered.

### **3. Foreign Investment and Operational Considerations; Residency and Material Visa Restrictions for Employees**

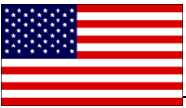
#### **a. Investing in Your Entity**

Generally, transferring funds into a newly formed United States business entity is not difficult. Funds generally flow freely between the United States and most other countries with very limited restrictions or capital controls. There are restrictions with respect to certain countries that are under sanctions from the United States (such as

Iran and North Korea) and for companies or persons who are on “watch lists” of potential terrorists or security risks maintained by the government. There is also a reporting requirement on movements of cash (or physical checks which are being carried rather than mailed) in excess of US\$10,000 across the U.S. border, but wire transfers generally occur without the need for any reporting by the transferee or recipient.

In addition, banks have “know your customer” rules that will require them to have copies of passports or other identifying and background information on one or more of your executives; usually that information is gathered when opening the account. Generally, opening an account will require a resolution of the Board of Directors (or other governing body if the entity is formed as a partnership or LLC) setting forth the individuals who will have authority over the bank account as well as copies of the account holder’s organizational documents, copies of the passports of the authorized signatories, and the entity’s taxpayer identification number.

Non-United States investors forming a United States company will want to consider the extent to which they will invest funds as debt or as equity. Like many other countries, the United States has “thin capitalization” rules. However, these rules generally only apply for tax purposes; there is not a requirement of minimum capitalization for corporate purposes other than such as is reasonably necessary and appropriate to carry out the business of the enterprise in light of its expected liabilities (i.e., the entity cannot be significantly undercapitalized without risk of piercing the corporate veil). Failure to meet the thin capitalization rules simply means interest



deductions on debt to the non-United States investor are denied to the United States company.

**b. Operational Issues**

**i. Annual Reports and Filings, Qualifications to Do Business.**

After forming a corporation, it is important to file annual reports, which for Delaware includes paying an annual franchise tax fee. A Delaware corporation's annual report must state the names and physical addresses of all the directors and officers and the physical address of the corporation's principal place of business. Annual reports in Delaware are due on or before June 30. Note that the franchise tax is calculated based on either authorized capital or on an "alternative basis" which requires the submission of certain U.S. tax schedules and considers the corporation's gross assets, total authorized stock and total issued stock. The authorized capital method results in higher tax when a large number of shares are authorized. Depending on specifics, filing under the alternative method may or may not ameliorate that result. For this reason, careful thought should be given at the outset to the number of shares authorized.

Failure to file an annual report and pay franchise taxes can lead to the dissolution of a corporation. It is possible to reinstate a dissolved corporation, but penalties will apply and, in the meantime, stockholders of the corporation may be exposed to liabilities.

There are similar requirements to pay annual franchise taxes for other forms of business entities, but not necessarily to file an annual report. In Delaware, for

instance, an LLC pays its annual franchise tax without having to file an annual report. Accordingly, there is no public record in the State of Delaware as to the names or addresses of an LLC's members or managers. And the same franchise tax applies to all Delaware LLCs, regardless of size.

Businesses are also required to file to qualify to do business in each state in which they do business, and each state has a different statute defining "doing business" for these purposes. Usually, having property (including leased property, such as an office) or employees in a state will result in a filing requirement, among other things.

For tax purposes, federal United States income tax returns must be filed annually for corporations; entities taxed on a flow through basis also must file annual information returns. Quarterly estimated tax payments are also required. Once a business qualifies to do business in a state, it will likely need to file tax returns in that state as well. Income earned in the United States will be apportioned among the different states in which a corporation does business.

**ii. Additional Investments and Offerings**

After an entity is formed, it often requires additional investment, which, as noted above, may come in the form of debt or equity. If additional equity investment is needed, it is often necessary to amend the charter to authorize additional shares of stock. In many cases, investment from new investors comes in the form of new series or classes of stock, most often, new classes of preferred stock (these classes are usually labelled with new letters, so there will be Series A Preferred, Series B



Preferred, etc.). These new series of stock may have priority over or be on par with earlier series of stock, so that they receive an investment return either before or alongside of those earlier series.

Preferred stock often includes protections for the holders of such preferred stock, such as rights to veto major corporate actions (sales of the corporation, issuance of dilutive securities, changes to the charter or bylaws), rights to participate in new offerings (“preemptive rights”), rights to participate in sales of stock by other stockholders (“tag-along” or “co-sale” rights), and even rights to force a sale of stock by other stockholders (“drag-along” rights). This is particularly true in the venture capital or private equity marketplaces, and the National Venture Capital Association maintains model documents that can provide considerable background on how these rights are used and what the documents for such investments look like. Delaware law also provides for special “class votes” when a class of stock is effected in a manner different than other classes, and this special approval can often be critical to major transactions, such as mergers and acquisitions.

All issuances of equity need to be conducted either in accordance with, or pursuant to an applicable exemption under, the United States securities regulations and in accordance with the “blue sky” laws applicable in the states where the securities are being offered for issuance. For wholly-owned or closely held corporations, such securities laws will not usually be of any substantive concern. But if shares are being issued to others (whether it be to “friends and family” or to unrelated third-party

purchasers), securities laws will typically limit to whom those shares can be issued and require compliance with significant disclosure requirements that vary depending on the nature of the investors and the aggregate amount that they are investing.

United States securities regulations also provide special and very detailed rules for public offerings. While the overall rules for public offerings are beyond the scope of this overview, the ability to buy or sell stock on the public market may be restricted to certain “registered” shares even after a company has become publicly listed, unlike many other countries where simply “listing” provides access to the market. Thus, most investors in United States companies will negotiate “registration rights” at the time of making an investment. Registration rights agreements set rules for what shares first become liquid following an initial public offering.

### **iii. Taxes on Transfers to Non-United States Investors.**

Transfers from the United States to stockholders or investors in another country are potentially subject to withholding taxes. Which withholding taxes apply, however, depends on the underlying facts for specific transfers: is the transfer a return of debt, a payment of interest, a corporate dividend coming out of earnings and profits of the subsidiary, a corporate distribution that is not drawn from earnings and profits (probably a return of capital), a royalty payment, a payment for management services, or something else? Is the transfer governed by a tax treaty between the United States and the country of the recipient?



When a non-United States business forms a United States subsidiary, it will usually enter into an intercompany agreement with that subsidiary which will help ensure that transfers occur in the most tax efficient manner. Withholding rates on different types of income can vary from zero to thirty-five percent, so properly characterizing payments back to the home country will be very important. Intercompany agreements are usually drafted with input from both the accountants and lawyers advising the business.

Withholding tax issues can be particularly important for non-United States investors in partnerships, limited liability companies, and other pass-through entities. Generally, these entities must determine withholding tax liabilities at the time income is earned, not at the time distributions are made. As a result, there may be withholding taxes due from the entity even when no distributions are made.

In general, for a United States corporation, withholding taxes are due at the time of a transfer, and there is an annual report filing by March 15 of the following year. Withholding taxes can often be substantially reduced or eliminated under a tax treaty, but taking advantage of the tax treaty will require the timely filing of a form (W-8BEN) with the United States Internal Revenue Service claiming treaty benefits. In addition, taxpayers subject to withholding under the U.S. Foreign Account Tax Compliance Act (“FACTA”) generally are subject to a full withholding tax and must file a claim for refund to claim any benefit of reduced taxes under a treaty.

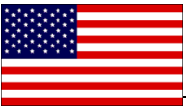
#### **iv. Employee Tax Issues.**

The United States also requires all employers, regardless of what form of entity is used, to withhold taxes from amounts paid to employees, and to file employment tax returns showing all such amounts. Most businesses will use a local payroll servicing company to manage the withholding process.

Executives transferred to the United States will have special considerations. Upon becoming resident in the United States, an executive will be taxed in the United States based on his or her worldwide income (subject to credits for foreign taxes paid), and will be required to fully report all non-United States bank accounts and possibly other holdings. In many cases, an executive may be well-advised to engage in tax planning prior to becoming resident in the United States in order to minimize the impact of these requirements.

#### **c. Special Business or Investment Visa Issues**

Anytime a business in the United States wishes to host, train, or employ a foreign national not already authorized to work in the United States, they must obtain the appropriate immigration status for that worker or face penalties. A visa is a passport stamp, issued by the State Department, which allows the foreign national to travel to the United States and request admission under a particular immigration status. In most cases, the underlying immigration status justifying a visa must also be approved by U.S. Citizenship and Immigration Services prior to applying for a visa at a U.S. consulate abroad. A brief discussion of several of the most widely used classes of temporary and



permanent visas (statuses) follows in this Section.

### Temporary

- **Business Visitor Visas (B-1).** This is available to foreign nationals who are surveying potential investment opportunities, attending a conference or trade show, conducting independent research, participating in a short-term training program, or giving a guest lecture or speech. The B-1 status is for a limited period of time (usually less than six months). To qualify for this status, the visitor cannot remain in the United States to manage their investment, perform productive employment, or receive any salary (other than reimbursement for expenses) from U.S. based companies.
- **Temporary Worker Visas (H-1B, H-2B, H-3, L, O).** These are available for foreign employees who fall within several specific categories. The H-1B is for specialty occupations, which generally are professionals whose position require at least a bachelor's degree or higher, fashion models, or researchers for Department of Defense projects. H-2B visas are for seasonal work and limited to nationals from designated countries. Both H-1B and H-2B visas are subject to quotas. H-3 visas are available for training in any field (except graduate medical education) that is not available in the foreign national's home country. Persons with extraordinary ability as evidenced by national or international acclaim may qualify for O visas/statuses. L visas/statuses are for professionals who need to work in the United States at a

branch, parent, affiliate, or subsidiary of their current, foreign employer.

- **Treaty Trader and Investor Visas (E-1, E-2).** If a foreign national is from a country that maintains a treaty of commerce and navigation with the United States, (s)he may qualify as an E-1 treaty trader or E-2 investor. To qualify, the foreign national must be engaged in substantial trade or investment, and must be an essential employee or possess highly-specialized skills.

### Permanent

- **Employment Immigrant Visas/Statuses (EB-1, EB-2, EB-3, EB-5).** The U.S. State Department issues approximately 140,000 employment-based immigrant visas (otherwise known as green cards) each year. Top priority (EB-1) goes to persons with "extraordinary ability" (international recognition in their fields) and multinational executives with an overseas affiliate, parent, subsidiary, or branch of a U.S. employer. EB-2 visas are issued to foreign nationals who fill positions in the national interest that require the skills of someone with an advanced degree, or to those who possess exceptional ability in their field (although the latter category of EB-2 visas also requires certification from the Department of Labor that qualified U.S. workers are not interested in the position). Third priority goes to EB-3 visa applicants, who are skilled professionals or workers, and must provide certification from the Department of Labor that qualified U.S. workers are not interested in the position. Historically, long wait times ranging from 5-10 years exist for EB-3





visas, especially for foreign nationals from Mexico, India, and China. EB-5 visas are for immigrant investors who engage in new commercial enterprises that invest at least \$1,000,000 in capital (\$500,000 in high-unemployment or rural areas), and create full-time jobs for at least 10 U.S. citizens.

There are additional types of immigration statuses which authorize employment in

the United States. Whether a foreign national qualifies generally is dependent on the type of work being performed, his or her qualifications, and the type of employer. Careful consultation with legal counsel experienced in business immigration matters is recommended for any company that is considering employing foreign nationals in the U.S.