Fall 21

INTERNATIONAL LAWYERS NETWORK

ESTABLISHING A BUSINESS ENTITY: AN INTERNATIONAL GUIDE

ILN CORPORATE GROUP

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Types of business entities

The two most common types of legal entities adopted in Argentina are the limited liability company ("Sociedad de Responsabilidad Limitada" or "SRL") and the corporation ("Sociedad Anónima" or "SA").

In 2017, Argentina incorporated a new type of legal entity, the Simplified Company ("SAS"), which was expected to simplify procedures, corporate bodies and reduce costs for new companies. However, as of the time of writing an amendment to the regulation of the SAS is being considered by the Legislative Branch, which could significantly reduce the access to this type of entity as well as increasing the bureaucratic burden. Below you will find a comparative analysis of the most relevant characteristics and the basic differences between SRL, SA and SAS.

CORPORATION	SIMPLIFIED CORPORATION	LIMITED LIABILITY COMPANY "SOCIEDAD DE RESPONSABILIDAD LIMITADA"
Creation: A *sociedad anónima* ("SA") must be formed through a public deed, and then be registered with the Public Registry of Commerce. The name of the company must include the words "Sociedad Anónima" or the abbreviated form "S.A."	Creation: A *sociedad por acciones simplificada* ("SAS") may be formed through a public deed or through a private document. The name of the company must include the words "Simplified Company" or the abbreviated form "S.A.S.". The duration of the existence of the SAS is 20 years, which can be renewed by the shareholders.	Creation: A *sociedad de responsabilidad limitada* ("SRL") may be formed through a public deed or through a private document, and then it must be registered with the Public Registry of Commerce. The name of the company must include the words "Sociedad de Responsabilidad Limitada" or the abbreviated form "S.R.L."
Capital: The corporate capital is divided in shares. The SA may issue classes of shares having the right to more than one vote per share. Shares must be issued in registered form. The minimum registered capital to create a SA is AR$ 100,000 (approx. US$1,000). Subscribers must pay in at least 25 % of the subscribed capital amount at the time of the creation of the SA. If the SA has only one shareholder the capital must be paid in a 100% at the time of incorporation.	Capital: The corporate capital is divided in shares. The SAS may issue classes of shares having the right to more than one vote per share. Shares must be issued in registered form. The capital cannot be less than an amount equivalent to two (2) times the minimum wage (this currently amounts to approx. U$S 500). The capital has to be proportionate to the company's purpose and the Registry can request a higher initial capital (the usual requirement is now AR$ 100,000). Subscribers must pay in at least 25 % of the subscribed capital amount at the time of the creation of the SAS if it	Capital: The corporate capital is divided in quotas. All quotas must have the same face value and voting rights. Quotaholders may own more than one quota. Although there is no minimum registered capital to create an SRL, the Registry usually requires approx. 30% of the minimum capital of an SA, i.e., AR$ 30,000 (approx. US$300). Subscribers must pay in at least 25 % of the subscribed capital amount at the time of the creation of the SRL.

	is in cash; if it is in kind the 100 % must be paid at the time of incorporation.	
Shareholders: The SA may have one (1) or more shareholders. Shareholders may be individuals or companies, whether local or foreign. Should the company have two or more shareholders, the Public Registry of Commerce requires that the minority shareholder hold at least 2% of the corporate capital.	Shareholders: The SAS may have one (1) or more shareholders. Shareholders may be individuals or companies, whether local or foreign.	Quotaholders: The SRL requires at least two quotaholders with a maximum of fifty. Quotaholders may be individuals or companies, whether local or foreign. Should the company have two or more quotaholders, the Public Registry of Commerce requires that the minority shareholder hold at least 2 % of the corporate capital.
Participation in other companies: An SA can only be part of another SA (corporation) or SRL. A single-shareholder SA cannot be a shareholder of other single-shareholder companies.	Participation in other companies: A single-shareholder SAS cannot be a shareholder of other single-shareholder companies.	Participation in other companies: SRL are not subject to limitations regarding participation in other companies.
Board of Directors: The administration of the SA is performed by a Board of Directors, with at least one member. Directors must be individuals and not legal persons. The directors do not need to be shareholders. Directors must procure a tax ID in Argentina. The majority of the directors must have their domicile in Argentina (please note that the requirement is residence and not nationality). Directors may hold office for a maximum period of three consecutive terms. However, their appointment is renewable without limitations. The board must meet at least once every three months. The representation of the SA is carried out by the Chairman of the Board of Directors. Directors have to obtain assurance while they are members of the Board. For alternate directors is	Board: The board may have one or more members, of whom at least one should be an Argentine resident. Directors must be individuals and not legal persons. Board members who are not Argentine resident should obtain a foreigner tax ID (CDI) and appoint a representative in Argentina, the special power of attorney for the appointment of the representative in Argentina has to be presented before the Public Registry of Commerce. One of the board members must act as legal representative of the SAS. Directors may hold office for a determinate or indeterminate period. Directors have to obtain assurance while they are members of the Board. For alternate directors is optional, until they occupy a position in the board.	Managers: The administration of the SRL is performed by one or more managers. The managers may act individually or as a corporate body similar to a board of directors. Managers must be individuals and not legal persons. The managers do not need to be quotaholders. Managers must procure a tax ID in Argentina. The majority of the managers must have their domicile in Argentina (please note that the requirement is residence and not nationality). Managers may hold office without term limitations. Directors have to obtain assurance while they are members of the Board. For alternate directors is optional, until they occupy a position in the board.

optional, until they occupy a position in the board.		
Directors Liability: Directors are jointly and severally liable vis-à-vis the company, shareholders and third parties for the poor performance of their duties, as well as for non-compliance with the law, bylaws, or regulations and for any damages caused by fraud, abuse of their faculties or serious fault. They must fulfill their obligations in a loyal way and as a "good businessman". There are some exceptions to the rules described above.	Directors Liability: The directors are individually or jointly liable, depending on the organization of the management and the regulation of its operation established in the contract. If a plurality of directors participated in the same events generating responsibility, the court may determine their liability pursuant to their personal involvement in the events. Provisions relating to the responsibility of directors of an SA are applicable when management is organized as a board.	Managers Liability: The managers are individually or jointly liable, depending on the organization of the management and the regulation of its operation established in the contract. If a plurality of managers participated in the same events generating responsibility, the court may determine their liability pursuant to their personal involvement in the events. Provisions relating to the responsibility of directors of an SA are applicable when management is organized as a board.
Shareholders' Meeting: Annually, the Shareholders' Meeting considers the financial statements, and if profit has been obtained it can approve the distribution of a dividend to the shareholders.	Shareholders' Meeting: Annually, the Shareholders' Meeting considers the financial statements, and if profit has been obtained it can approve the distribution of a dividend to the shareholders. Resolutions may be adopted through written consents.	Quotaholders' Meeting: Annually, the Quotaholders' Meeting considers the financial statements, and if profit has been obtained it can approve the distribution of a dividend to the quotaholders
Corporate Records: An SA must have at least four corporate books, as follows: Shareholders' Meetings Minutes, Board Meetings Minutes, Shareholders Registry and Attendance to Shareholders' Meeting Registry plus accounting records.	Digital Records: The SAS must keep the following electronic records: Minutes Book, Shareholder's Registry, and accounting records.	Corporate Records: An SRL may have only one corporate book for Quotaholders' and Managers' Meetings Minutes plus accounting records.
Syndic/Syndic's Committee: Syndics act as internal auditors of an SA, verifying that it complies with applicable law. All syndics must be lawyers or accountants. The appointment of one or more syndics is optional, unless the SA (i) has a corporate capital in excess of AR$ 50,000,000 (approx. USD 500,000), (ii) has only one	Syndic/Syndic's Committee: The appointment of one or more syndics is optional, unless the SAS (i) has a corporate capital in excess of AR$ 50,000,000 (approx. USD 500,000), (ii) has only one shareholder, (iii) is a public company, (iv) is owned by the government (51 % or more of shares), (v) is engaged in financial	Syndic/Syndic's Committee: Only an SRL with a corporate capital in excess of AR$ 50,000,000 (approx. USD 500,000) must appoint a syndic.

shareholder, (iii) is a public company, (iv) is owned by the government (51 % or more of shares), (v) is engaged in financial or savings activities, (vi) is a public utilities company, or (viii) controls or is controlled by a company included in items (i) through (vi) above.	or savings activities, (vi) is a public utilities company, or (viii) controls or is controlled by a company included in items (i) through (vi) above.	
Transfer of Shares: Shares may be transferred without limitations, and any transfer is registered in the Shareholders Registry.	Transfer of Shares: Shares may be transferred without limitations, and any transfer is registered in the Shareholders Registry, along with the stock purchase agreement.	Transfer of Quotas: Quotas may be transferred without limitations. However, the transfer must be registered with the Public Registry of Commerce to be enforceable against third parties.
Shareholders' liability: Shareholders are granted limited liability for the liabilities in which the SA may incur. Only in certain cases of bankruptcy or of fraud (in particular, in the fields of labor and tax law) the shareholders may be held liable for the SA's obligations.	Shareholders' liability: Shareholders are granted limited liability for the liabilities in which the SAS may incur. Only in certain cases of bankruptcy or of fraud (in particular, in the fields of labor and tax law) the shareholders may be held liable for the SAS' obligations	Quotaholders' liability: Quotaholders are granted limited liability for the liabilities in which the SRL may incur. Only in certain cases of bankruptcy or of fraud (in particular, in the fields of labor and tax law) the quotaholders may be held liable for the SRL's obligations.
Corporate Obligations: Annually, the SA must file its financial statements with the Public Registry of Commerce, as well as a service fee to the Public Registry of Commerce (which is not significant).	Corporate Obligations: Annually, the SAS must file its digital financial statements with the Public Registry of Commerce.	Corporate Obligations: Only SRL with a corporate capital in excess of AR$ 50,000,000 must file its financial statements with the Public Registry of Commerce.

2. Other relevant corporate matters

- Shareholders: Any foreign person (individuals or legal entities) can be a shareholder of a company organized in Argentina. In order to participate in local companies in Argentina, foreign companies must register before the local Public Registry of Commerce. The Public Registry of Commerce of the City of Buenos Aires has extensive requirements and limitations relating to this registration. Both individual and legal entities shall obtain a foreign Tax ID before local Tax Authorities.

- Directors: Depending on the type of entity, one or more of the board members must be Argentine residents. Non-Argentine board members will need to obtain a local Tax ID before local Tax Authorities and pay social security taxes in connection with their position as directors.

- Permits: Depending on the company's purpose and industry in which company's activities are carried out, certain permits might be necessary to operate.

Please find below a general description of the main taxes applicable to companies in Argentina. This should be analysed on each

specific case as exceptions or special regimes may apply.

NATIONAL TAXES:

Corporate Income Tax (CIT): Resident companies are subject to CIT on a worldwide basis. The income tax law has recently been amended in relation to CIT. The current law changes the fixed tax rate (30%) applicable until fiscal year 2020 for a progressive one, according to the following criteria:

a) if the net income of the company does not exceed ARS 5 million (approximately USD 50,000) in the fiscal year, a 25% tax rate applies;

b) if the net income range exceeds ARS 5 million but is less than ARS 50 million (approximately USD 500,000), a tax rate of 30% applies to the income exceeding ARS 5 million; and

c) if the net income exceeds ARS 50 million, a tax rate of 35% applies to the income exceeding ARS 50 million.

Withholding tax in dividends: A withholding tax of 7% applies to the payment of dividends.

Value Added Tax: the general VAT rate for Argentine local transactions is 21 %. For certain goods or services could be 10,5%. There are also exemptions that may apply. For example, exports are levied at a 0% VAT and exporters can be reimbursed for the local VAT paid related to its exportation.

Bank credits and debits tax: credits and debits on local bank accounts are subject to a 0.6 % tax rate on the debits and a 0.6 % tax rate on the credits. In general, depending on the kind of activity of the local entity certain exceptions may apply. There is an additional 1.2% tax rate for cash withdrawals, except for PyMES (Small and Medium Size entities). In general, this tax generates a tax credit of 33% that can be used to offset income tax or its instalments.

Customs duties: Import/export of "goods" are taxed at different customs rates according to each tariff position (identification for customs purposes). Exports of "services" are also considered merchandise under the Customs Code, and subject to an export duty. This export duty has been established at a rate of 5% on the amount invoiced for the service exported and will be in force until December 31st, 2021 (its validity may be extended). For SMEs (Small and medium-sized enterprises) there is a non-taxable minimum amount of USD600,000 per year.

Social security taxes (SST):

Employers Contribution for SST: The social security tax rate for employers which activities are related to commerce or services and who are not a SMEs[1] is 20,40% and for the rest of employers the tax rate is 18,00%. The health care tax rate is 6%. So, it is 26,4% for the first case and 24% for the second one and applies on the gross salary.

Employee Payment for SST: Please note that the local company shall withhold the relevant social security taxes from the employee's salaries which represent approximately 17% of the gross salary, health case included. Also, the company shall withhold the income tax from the employee's salaries if applicable.

TAXES ON SHAREHOLDERS:

Capital gains tax (Direct or Indirect Sale): In broad terms, direct or indirect sale is taxable at a 15 % on the net gain (sale price minus acquisition cost) or 13.5% of the total sale price (gross Price of the operation). There are some

[1] SME: small and medium-sized enterprises.

requisites to comply with for the indirect capital gains to be taxed. If there is a seller located abroad and in a non-cooperative jurisdiction the tax rate will be higher (35% net gain or 31,5% gross price of the sale).

Wealth tax on shares: A 0.50 % tax rate on the book value of the equity held in the local company. The local company pays this tax on behalf of the shareholders.

Transfer Pricing Rules: Transfer pricing rules in Argentina follow the OECD Model, based on the principle that transactions between an Argentine company and related companies based outside of Argentina (or with companies located in non-co-operative, low- or no-tax jurisdictions) must be done in arm's length conditions. Argentina's rules include the five methods from the OECD model, but in addition to the five OECD methods, Argentina has an additional rule, called the 'sixth method', which in general applies to the import and export of commodities made through an international related intermediary or an intermediary located in a non-co-operative jurisdiction or low-tax jurisdiction.

Thin Capitalization Rules: In line with international standards (OECD guidelines), interest on financial debts (excluding, as a consequence, debts generated by acquisitions of goods, leases and services related to the company's business) owed to related parties (Argentine residents or not) will be deductible subject to certain quantitative limitations. The deductibility limitation on the interests does not apply to financial entities, certain financial trusts, or when a WTX (withholding tax) apply in relation to the interest paid, among others.

CFC Rules: In broad terms, local residents in Argentina having participation in foreign entities that don´t pay taxes abroad in the relevant jurisdiction (despite the fact that the relevant jurisdiction has a corporate tax regulated) or local residents that have direct or indirect participation of 50% or more on entities that obtain passive income in certain ratio, or local residents having control over trust or foundations located abroad have to monitor this particular set of rules on a case by case basis to determine if they have or they have not to recognize income from such entities or trusts on an accrual basis.

Tax Havens and non-cooperative jurisdictions: The Income Tax Law includes different tax effects when a jurisdiction qualifies as tax haven or non-cooperative. Such effects should be analyzed on a case by case basis, but in general, the qualification of a jurisdiction for those concepts are as follows: 1- countries, territories or tax regimes that establish a corporate income tax rate that is lower than 15% will be considered low or no tax jurisdictions; 2- jurisdictions that do not have a tax Information Exchange Agreement or a Double Taxation Treaty with broad clauses of Information Exchange in force will be considered non-cooperative jurisdictions. The Income Tax Implementing Decree includes a list of "non-cooperative jurisdictions" in Section 24.

LOCAL TAXES:

Turnover tax: A 3 % average tax rate on gross income. Such rate may be increased to 5 % in accordance with the company's annual gross income. Note that such tax rate may also vary depending on the activity developed. Exemptions may apply.

Stamp tax: A 1 % tax rate over the value of written contracts. This tax may not apply if the instrumentation of the document is made by offer/acceptance letters.

Municipal tax: city councils apply different taxes which usually amount to 0,5% or 1 % of the gross income of the company.

Argentina has a clear pro-employee labor legislation.

The usual practice in Argentina regarding labor agreements is to use verbal agreements (as opposed to written agreements) for indeterminate duration, which main conditions (wages, initial date, etc.) are registered with the tax authorities and in the company's registry. Lack of registration of the employees is considered labor fraud.

Wages must be paid by way of a wire transfer to the employee's bank account.

Dismissals require paying a severance compensation, which amounts to one monthly wage per year of seniority or fraction exceeding 3 months, in addition to one or two monthly wages of as pre-notice.

Due to the economic crisis, the severance for dismissals without cause has been doubled until December 31, 2021. Moreover, as a result of the COVID situation, dismissals without cause in Argentina have been suspended until December 31, 2021.

Failure to comply with Argentine labor laws could result in labor fraud penalties imposed on the employer and payable to the employee (e.g., 25% of all amounts irregularly paid) in addition to the social security and tax contingencies of the employer vis a vis the Tax Authorities.

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ESTABLISHING A BUSINESS ENTITY IN AUSTRALIA

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ESTABLISHING A BUSINESS ENTITY IN AUSTRALIA

TYPES OF BUSINESS ENTITIES

There are a number of business structures to choose from when starting a new business venture in Australia. Investors need to determine which form of business organisation is the most appropriate for their requirements.

The main types of business structures used by investors in Australia are:

- companies, including branch offices of foreign companies;
- partnerships;
- joint ventures; and
- trusts.

Each particular structure has advantages and disadvantages. Therefore, specific legal and accounting advice should be obtained before deciding upon the most appropriate investment vehicle.

Company

All Australian companies are regulated by the *Corporations Act 2001* (Cth) (**Corporations Act**).

A foreign investor can register an Australian company under the Corporations Act. The "limited liability" company is the most common business structure used by foreign investors in Australia.

A company is its own legal entity and has the same rights and obligations as an individual person. This means that a company can incur debt, can sue, and be sued, is taxed as a separate legal entity, and must file its own tax return.

A significant benefit in choosing a company structure is that the liability of the owners of the company (the shareholders) to third parties is generally limited to the amount (if any), which is unpaid on their shares.

The most common company types are public companies and proprietary (or private) companies. A proprietary company is generally simpler and less expensive to administer than a public company because it is subject to fewer administrative requirements imposed by the Corporations Act.

(a) Proprietary company limited by shares ("Pty Ltd")

This is the most common form of corporate business entity in Australia. The company is incorporated with share capital which is owned by the shareholders. The liability of the shareholders is limited to the amount which is unpaid on their shares.

Pty Ltd companies:

- must have at least one, but no more than 50, non-employee shareholders;
- must have at least one director residing in Australia;
- must have a registered office in Australia;
- must have a public officer, who is responsible for complying with the tax obligations of the company and dealing with the Australian tax authorities;
- may have a company secretary, but does not need to; and
- have fewer fundraising options available, compared to a public company.

Pty Ltd companies are further divided into "large proprietary" and "small proprietary" companies.

The Corporations Act sets out certain tests to determine whether a company is

a "large proprietary" or a "small proprietary" company.

There are less disclosure requirements imposed on a small proprietary company, including that its financial reports do not need to be audited.

(b) Public company (Limited)

Public companies involve ownership by the public and they are not restricted by the same limitations that apply to Pty Ltd companies. A public company is able to raise capital directly from the public by offering shares and other securities. Subject to certain requirements as set out in the 'ASX Listing Rules', public companies may also apply for listing on the Australian Securities Exchange in order to get access to capital markets.

Public companies

- must have at least one shareholder with no upper limits on the number of shareholders;
- must have at least three directors, two of whom must ordinarily reside in Australia;
- must have at least one secretary, who ordinarily resides in Australia;
- must have an auditor;
- must have a public officer for tax purposes;
- must have a registered office in Australia that is open each business day for a prescribed amount of time; and
- may raise capital by issuing a disclosure document to offer shares and other securities to the public.

Establishing a Pty Ltd company

The process for incorporating a Pty Ltd company in Australia is relatively straightforward and inexpensive. It is also a relatively quick process - provided that all relevant information is provided, a company can be registered in a couple of days.

(c) Choose a company name

Before registering a company, the owners must choose the name for the company. The appropriate searches should be conducted to ensure that the proposed company name is not identical or similar to another Australian company or business name, and that it does not infringe on the intellectual property rights of another business or individual.

If the company wishes to trade using a name that is different to the company's registered name, then it must register this name separately as a business name with ASIC.

(d) Consider internal operations

Before registering the company, the owners will need to decide what the governance framework for the company will be. For example, how directors will be appointed and removed, the terms of issue for shares, the right of shareholders to receive dividends, and the process for transferring shares.

Usually, these governance issues are addressed in a document called a constitution. Sometimes, the constitution is also supplemented by an additional agreement entered into by shareholders called a "shareholders agreement".

The constitution is usually adopted upon the registration of the company. If a constitution is not adopted upon the

registration of the company, then the "replaceable rules" in the Corporations Act will apply. However, the "replaceable rules" do not cover all governance matters, so it is preferable for a company to adopt its own constitution upon registration.

(e) Registration

In Australia, a company is registered by using the Australian Government's Business Registration Service.

The application for registration must contain details of the following:

- the directors of the company (one of whom must reside in Australia);
- the company secretary (if the company is to have one). If the company has more than 2 secretaries, then at least one must reside in Australia;
- the shareholders of the company and the number of shares held by each shareholder;
- the address for the registered office of the company and its principal place of business;
- the amount paid by each shareholder for its shares;
- the proposed name of the company; and
- details of any ultimate holding company of the company.

Any constitution for the company must also be lodged.

Once registration is complete, the company will be issued an Australia Company Number (**ACN**). The company's name and ACN must be displayed on documents published by the company, and wherever the company conducts business.

Australian Branch

An overseas company wanting to carry on business in Australia must either incorporate a new company in Australia (refer above) or register itself as a foreign company with ASIC.

Registration of a branch office under the Corporations Act gives the overseas company the right to carry on business in Australia. The overseas company must comply with Australian law and is subject to certain reporting and disclosure requirements.

A foreign branch is not classified as a separate legal entity. Therefore, the overseas company will be liable for all of the debts and obligations of the Australian branch.

An Australian branch of a foreign company:

- is taxed as a separate entity in Australia;
- must have a local agent who is responsible for the company's obligations in Australia; and
- must have a registered office in Australia.

Choice of Australian Branch or Subsidiary

There are a number of factors to consider when deciding to establish an Australian branch or a subsidiary.

These factors include the following:

- a subsidiary is a separate legal entity from its parent company. It has limited liability and the parent is not usually liable for the debts or obligations of the subsidiary. There are some exceptions to this, such as in the case of the insolvency of the subsidiary;
- an Australian branch of an overseas company is not a separate legal entity. Therefore, the overseas company will be

liable for all debts and obligations of the Australian branch;

- the use of an Australian branch may cause practical difficulties when dealing with financiers. For example, if finance from an Australian financial institution is required, then that institution may require audited financial statements relating to the Australian operations of the applicant. This may not be readily available in an acceptable form in the case of an Australian branch;
- the use of a branch may also cause some difficulties when dealing with third parties. For example, they may need to be satisfied as to the nature of the foreign corporation's legal structure and the means by which it is able to bind itself to obligations in Australia; and
- the annual return of a branch office must include the worldwide financial accounts of the company of which it is a branch, unless exempted by ASIC. This document is available to the public.

Partnership

A partnership is an arrangement between two or more entities to carry on a business together with a view to a profit. Except for certain professional partnerships, business partnerships cannot have more than 20 partners.

A partnership is created by an agreement among the partners. Usually, this agreement is documented in a written partnership agreement. Partnerships are regulated by the terms of the partnership agreement (if there is one), the common law and the relevant Partnership Act which applies in the applicable state and territory.

A partnership is not a separate legal entity. Therefore, each partner is jointly and severally liable for the debts of the partnership. Partners also share in the profits of the partnership.

Limited partnerships can also be established in some states under specific state legislation. Limited partnerships allow some partners to limit their liability for debts. Limited partnerships are generally taxed as companies.

Joint Venture

A joint venture occurs when two or more parties come together in order to undertake a specific project. The joint venture arrangement can be incorporated or unincorporated.

(f) Unincorporated Joint Venture

In an unincorporated joint venture, the parties usually enter into a joint venture agreement, which sets out the rights and obligations of each joint venture party.

Each party is treated individually or separately for tax purposes. This enables each party to use its own preferred tax structure.

The main disadvantage of a joint venture is there is often joint liability to third parties.

(g) Incorporated joint venture

In an incorporated joint venture, the joint venture is conducted by a company. The company is often established for the specific joint venture, and each party is a shareholder. The shareholders usually enter into a shareholder's agreement, which sets out the rights and responsibilities of the shareholders. The parties must also comply with the Corporations Act.

Trust

An Australian business may be carried on by way of a trust.

Under a trust structure, the trustee (who may be an individual or more commonly a company) conducts the business and holds all income and capital on trust for the beneficiaries. The beneficiaries can be individuals, trusts or companies.

The trust is created by a document called a trust deed. The trust is governed by the terms of the trust deed, Australian state or territory legislation and the common law.

Trusts fall into two categories: discretionary trusts and unit trusts.

(a) Discretionary trusts

Under a discretionary trust, the trustee has discretion to distribute the income and capital of the trust to any of the beneficiaries. It is common for discretionary trusts to have specified (or named) beneficiaries, as well as classes of general beneficiaries (which may include the family members of a named beneficiary).

One of the benefits of a discretionary trust is the trustee has the ability to make distributions which consider the beneficiaries individual tax circumstances. Discretionary trusts are most often used for family-owned businesses. Generally, discretionary trusts are not an appropriate investment vehicle.

(b) Unit trusts

Under a unit trust, the beneficiaries (referred to as unitholders) subscribe for units in the trust. Each unitholder has an interest in the capital and income of the trust that is relative to the number of units that they hold. Unit trusts have the benefit of conferring a clearly defined entitlement and are often considered more appropriate than a discretionary trust for non-family business ventures.

Sole Trader

This is the simplest form of business structure. A sole trader is an individual person who carries on business as an individual under their own name or under a registered business name. A sole trader is personally liable for all debts of the business.

Managed Investment Schemes

A managed investment scheme (**MIS**) enables a group of investors to contribute capital in consideration of acquiring a right in the benefits of the scheme. The contributions are pooled for investment (typically in a trust-based arrangement) or used in a common enterprise, in order to produce that benefit. Investors do not have day-to-day management of the MIS' operations. Instead, a MIS is managed by a 'responsible entity' with an Australian Financial Services Licence (**AFSL**), acting in accordance with the scheme's constitution and the Corporations Act.

Where a MIS has 20 or more retail clients, it must be registered with ASIC, and its 'responsible entity' must be a public company with at least three directors.

COMPARISON – PROS AND CONS OF EACH BUSINESS STRUCTURE

Structure	Advantages	Disadvantages
Sole Trader	• Simple to set up and operate • The owner retains control of the business and over its decision making. Therefore, the owner is able to exercise flexibility and speed in regard to decision making. • Less regulatory requirements.	• No separate legal existence - the owner will be responsible for all debts and liabilities of the business. • Creditors have the right to claim against the personal assets of the owner. • Limited access to capital if the business grows. • No continuity of existence – without a succession plan, the business will not survive if the initial owner dies.
Partnership	• Simple and relatively inexpensive to set up – a partnership can be set up informally by the parties carrying on business together with a view to a profit. However, a written partnership agreement is recommended. • Partners can combine their financial resources and expertise. • Tax is paid by the partners on their own tax returns and at their own marginal tax rates. • Tax losses of the partnership can be used to offset the partners' personal tax liabilities. • Partnerships are under no obligation to make public disclosures of accounts and reports. • The partnership structure is often more flexible than other structures.	• No separate legal entity, so partners are jointly and severally liable for the debts and obligations of the partnership. • Statutory limits on the number of partners allowed. • Difficulties can arise when there is a change in the partnership structure (e.g.: when a partner leaves the partnership).
Company (including incorporated joint ventures)	• Investment is easier - shares can be transferred. • Limited liability for shareholders – the personal liability of shareholders is limited to the amount (if any) unpaid on their shares.	• Ongoing costs (accounting and reporting) and compliance. • Loss of control – directors rather than shareholders make management decisions. • Directors can be personally liable in certain circumstances (refer to

	• Can be easier to raise finance. • It continues indefinitely, so no succession issues. • Suitable for businesses that want to expand. • Taxation benefits - the differential between the corporate rate and the top effective personal tax rate may give rise to tax planning opportunities in certain circumstances. • Profits may be accumulated and re-invested by the company without the need for distribution to shareholders.	our comments in respect of director's liability below).
Trust	• Trusts may be more effective for tax purposes where assets are to be held for ultimate sale. • Trust structure can be more flexible than a company structure. For example, the legal restrictions that apply to reductions in the capital of a company do not apply to similar reductions in the capital of the trust. • Discretionary trusts have flexibility in the distribution of income.	• It can be expensive to set up a trust. • Trust structures are complex and are subject to numerous legal and regulatory requirements. • The trustee is subject to strict legal obligations.
Unincorporated Joint Ventures	• Each party is treated independently for tax purposes. • Flexibility in management/governance arrangements.	• There is usually joint liability to third parties.

CORPORATE GOVERNANCE AND REGULATION

Individuals, partnerships, and corporate entities that operate businesses in Australia are subject to a broad range of regulatory and reporting requirements which vary depending on a range of factors, including the:

- structure, nature, and ownership of the entity which conducts the business;
- state or territory in which the business is being conducted; and
- nature of the business being conducted (such as the type of goods or services that are provided).

Australian Securities and Investments Commission (ASIC)

Australian corporate entities are primarily governed by the Corporations Act.

ASIC is the national body that is responsible for regulating the incorporation, operation, and management of corporate entities in Australia. ASIC also hosts and maintains a public register

of Australian corporate entities, which is accessible by the general public.

The Corporations Act places ongoing disclosure and reporting obligations on Australian companies, including requirements for certain information to be provided to ASIC for the purposes of public records. These reporting obligations include:

- reporting any changes to their company details and structure (such as changes to company officers, shareholders, registered addresses or issued share capital) to ASIC within a specified time period after such change occurs;
- notifying ASIC before undertaking certain actions (such as providing financial assistance to a person who is seeking to acquire securities in that company); and
- lodging financial reports with ASIC each financial year (this obligation applies only to entities that are considered "disclosing entities", as defined in the Corporations Act).

Australian Securities Exchange

In addition to the obligations set out in the Corporations Act, public companies that are listed on the Australian Securities Exchange (**ASX**) must also comply with the ASX's listing rules and regulations. The key functions and responsibilities of the ASX are to:

- act as a market operator, clearing house and payments system facilitator for companies listed on Australia's public securities market exchange; and
- oversee the compliance with, and enforcement of, the ASX listing rules and other regulations.

Taxation Obligations

The Australian taxation system can be described as a self-assessment model, whereby taxpayers are responsible for lodging their own tax returns with the Australian Taxation Office (**ATO**) at the end of each relevant reporting period.

Tax File Numbers and Australia Business Numbers

Given that companies are considered as separate legal entities, companies are required to obtain their own Tax File Number (commonly known as a TFN) for the purposes of complying with their taxation obligations.

Companies that conduct business activities are also required to apply for an Australian Business Number (commonly known as an ABN), which is used for the purposes of allocating and calculating any tax payable on the company's business income.

Income Tax Returns

Individuals and companies are generally required to lodge an annual income tax return at the end of each Australian financial year (which runs from 1 July to 30 June each year).

The income tax rate applicable to Australian business structures will depend on the type of entity that conducts the business. For example, the income tax rate for:

- Australian companies is generally fixed at 30%, except for those which qualify as "Small Business Entities"; and
- "Small Businesses Entities" (which are companies, unit trusts or public trading trusts which have an annual business turnover of less than AUD $50 million) has been reduced to 25% for the 2021-22 financial year.

Company Dividends and Tax Consolidation

Dividends paid by Australian companies to Australian resident shareholders are subject to a dividend imputation system, whereby shareholders are entitled to franking credits for

the tax that the company has paid on its profits (from which dividends are paid). The effect of franking credits is that dividends are ultimately taxed at each shareholder's applicable income tax rate and are not taxed at the full rate at both the company and shareholder level.

Australian corporate groups consisting of a parent company and a series of wholly owned subsidiaries are able to form what is known as a "consolidated tax group". Consolidated tax groups are treated as a single entity for income tax purposes, and transactions within the group are often disregarded for the purposes of calculating income tax.

Goods and Services Tax (GST)

GST is a broad-based tax of 10% which applies to most goods, services and other items sold or consumed in Australia. GST is a multi-stage tax (similar to a Value-Added Tax) that is payable by suppliers at all levels of the supply chain. GST registered entities are entitled to claim refunds of the GST that they have incurred on their business inputs.

Businesses or individuals carrying on an enterprise that has (or is expected to have) an annual turnover of more than a specified amount are required to register for GST purposes. The GST component of a business' sales must be reported to the ATO on either a monthly, quarterly, or annual basis by lodging Business Activity Statements (also known as BAS statements).

Certain non-resident entities are eligible to access a simplified GST registration regime, whereby they may either be liable to the ATO or entitled to a refund at the end of each relevant reporting period. Whether an entity is required to make additional GST payments or is entitled to receive a GST refund will depend on the amount of GST collected through sales, when compared to any tax credits received from GST paid on goods and services purchased by the business in the course of carrying on their enterprise.

Other Taxation Liabilities

In addition to lodging annual income tax returns, companies and other corporate or business entities may also have taxation liabilities in respect of:

- **Capital Gains Tax (CGT)** - CGT is imposed on the capital gains realized from the sale of certain assets. Assets that are sold by individuals or corporate entities that are considered Australian residents for tax purposes may trigger a CGT liability, even if the relevant assets were not located in Australia.
- **Fringe Benefits Tax (FBT) –** Employers are required to pay FBT on the value of the non-cash benefits or allowances that they provide to their employees. The FBT rate for the year ending March 2022 is set at 47%.
- **Superannuation Guarantee Charge (SGC) -** If an employer fails to pay the statutory minimum level of superannuation to their employee's nominated superannuation fund, the employer will be liable to pay the Superannuation Guarantee Charge. The SGC is an amount equal to the value of the relevant shortfall in statutory superannuation payments, plus interest (currently at a rate of 10%) and administrative charges.
- **State and Territory specific taxes**

  In additional to the federal taxes outlined above, each Australian State and Territory has their own taxation framework which may create additional tax liabilities for entities that conduct business in Australia. Examples of such state-based taxes include:

Payroll Tax: Each State and Territory has a Payroll Tax system under which an employer is liable to pay tax on the value of the employer's monthly payroll expenses (including any relevant fringe benefits). Payroll Tax rates are generally between 4-6% but may differ significantly between each State and Territory. Each State and Territory also has a monthly wage threshold test to determine whether or not an employer is required to pay Payroll Tax.

***Stamp Duty*:** Individuals or entities that acquire land, certain interests in real property or interests in other entities that have significant land holdings may be required to pay an additional state-based tax known as Stamp Duty. Acquisitions to which Stamp Duty may apply, and the relevant rate of such Stamp Duty, varies significantly from State to State. Acquisitions of real property by foreign investors will often attract a higher rate of stamp duty.

***Land Tax*:** Individuals or entities that are the registered proprietor of Australian real property will also incur an annual Land Tax liability. Similar to Stamp Duty, the types of real property that will attract a Land Tax liability, and the relevant rate of such Land Tax, varies significantly between the States and Territories.

It is important to highlight that, at the time of publishing, Australian State and Federal Governments are offering Australian businesses and companies significant tax relief and support payments to assist businesses during the COVID-19 trading restrictions. Professional advice is required to determine whether businesses are eligible to access these tax relief and support payment schemes.

Capital Raising Regulation

The Corporations Act provides a framework for regulating fundraising activities (including capital raising) within Australia. The relevant provisions of the Corporations Act impose rules regarding offers or invitations to subscribe for new 'financial products', including shares, units in a trust, partnership interests and debentures in respect of both private and publicly listed entities.

The underlying principal of the fundraising rules under the Corporations Act is that, unless a specific exemption applies, a person must not make an offer in respect of a new financial product before providing potential investors with a disclosure document. Depending on the circumstances of the offer and the characteristics of the target entity, the offering party may also be required to lodge a copy of the relevant disclosure documents with ASIC, prior to extending the offer to potential investors.

Generally speaking, a disclosure document must be in the form of a prospectus, which, depending on the nature of the financial product, can be either a long-form or short-form document. There are specific exemptions which allow for much simpler disclosure documents to be used in certain circumstances.

There are certain types of offers in respect of financial products which are exempt from the disclosure requirements set out in the Corporations Act. These include:

- offers to subscribe for new shares that are issued under an employee incentive scheme;
- offers to sell existing financial products (being financial products that are sold more than 12 months after the date that they were first issued);

- offers made to "sophisticated investors", being investors that hold net assets or have an annual income above a specified threshold;
- offers to "professional investors", such as stockbrokers or other persons who hold a financial services licence; and
- "small scale offerings", which are personal offerings made by an entity where no more than 20 investors will have acquired securities in the entity and no more than $2 million of capital is raised, within any 12-month period.

Importantly, companies (and in some circumstances, the company's directors) can be liable for civil and criminal penalties for failing to comply with the fundraising provisions of the Corporations Act, such as by:

- offering securities without a providing an appropriate disclosure document in the form required by the Corporations Act;
- making unsolicited offers of financial products and conducting advertising in respect of new financial products; and
- omitting required information from a disclosure document or producing a disclosure document that is misleading.

The regulatory framework around capital raising in Australia is robust and can be very complex. It is important that appropriate legal advice is sought before companies undertake capital raising activities.

Competition and Consumer Laws

Individuals and entities conducting business in Australia must also take note of Australia's Competition and Consumer protection laws, which are set out in the *Competition and Consumer Act 2010* (Cth) (**CCA**). At a high level, the CCA sets out the following prohibitions and consumer protections:

- **Prohibition on Anti-competitive Agreements** – Contracts, arrangements or understandings which have the purpose or likely effect of substantially lessening competition in the relevant market, are prohibited under the CCA.
- **Prohibition on Price fixing** – Competitors must not enter into any contract, arrangement or understanding that has the purpose or effect of fixing a price for the provision of goods or services.
- **Prohibition on Exclusive Dealing** – Generally speaking, exclusive dealing occurs when an individual or entity, when trading with another party, imposes restrictions on the other party's freedom to choose how they trade with other businesses. Exclusive dealing will be in breach of the CCA where the conduct has the effect of substantially lessening competition in the relevant market. Examples of exclusive dealing include:

  Third Line Forcing: Where a business will only agree to supply goods or services to another party on the condition that the party who receives those goods or services also purchases goods or engages the services of a particular third party.

  Full Line Forcing: Where a supplier refuses to supply goods or services unless the receiving party agrees not to purchase certain other goods or services from the supplier's competitors.
- **Prohibition on Resale Price Maintenance** - Resale price maintenance occurs when a supplier prevents, or attempts to prevent, a business (such as an independent retailer or distributor) from advertising or selling products below a specified minimum price. Suppliers are permitted to specify a *recommended retail price* for their products, however the CCA prohibits

suppliers from threatening not to supply goods if those goods are not sold at the recommended retail price, or from otherwise exerting pressure on retailers to sell the goods at a specified price.

- **Prohibition on Unconscionable Conduct** – Unconscionable conduct is a very broad concept that does not have a precise legal definition in the CCA. Broadly speaking, the CCA prohibition on unconscionable conducts seeks to prohibit business conduct that is harsh or oppressive, and that extends beyond the ambit of commercial bargaining or negotiation tactics.
- **Prohibition on Misleading and Deceptive Conduct** – The CCA prohibits persons from, in the course of trade or commerce, engaging in conduct that is misleading or deceptive or that is likely to mislead or deceive. Australian Courts have historically taken a very broad approach in determining the types of conduct that may be misleading or deceptive, which can include activities such as advertising, oral representations, as well as representations in respect to contractual matters.
- **Product Liability** – Businesses that manufacture goods or import goods into Australia for the purposes of resale will be liable to consumers for any safety defects in respect of the goods. The CCA provides that consumers may seek compensation from a manufacturer in respect of goods which have safety defects, if it can be established that the defects have caused the consumer to suffer loss or damage.

International Trading Considerations

Individuals or entities that conduct businesses in Australia with the intention of trading internationally should also familiarise themselves with the following concepts:

- **Transfer pricing** – Australia's transfer pricing regime requires that international related-party transactions must be made on arms' length terms. The primary purposes of the transfer pricing rules are to ensure that the consideration exchanged by the relevant related parties has been agreed on the basis of an acceptable pricing methodology, to ensure an appropriate level of tax is paid.
- **Customs duty -** Customs duty is imposed on goods imported into Australia. The rate of customs duty is generally around 5% of the value of goods (when converted to Australian dollars), depending on the type of goods being imported. GST may also be applied to goods at the time that they are imported.
- **Excise duty** - Excise duty is a commodity-based tax that applies to alcohol, tobacco, fuel, and petroleum products that are produced, stored, or manufactured in Australia. In addition to paying the relevant excise duty, businesses that produce, store or manufacture alcohol, tobacco or petroleum products are required to obtain and maintain an excise licence.

Other Regulatory Bodies

In addition to the regulatory bodies and agencies described above, individuals and companies that carry on businesses in Australia may also need to interact with (and comply with the relevant regulations enforced, or administered by) the following regulatory bodies:

- **Australian Prudential Regulation Authority (APRA)** - APRA is an independent statutory authority that was

formed to oversee the Australian financial services industry and enforce prudential financial standards. APRA's regulatory functions include the supervision of banks, insurance companies, building societies, credit unions, and superannuation funds.

- **Australian Transactions Reports and Analysis Centre (AUSTRAC) –** AUSTRAC is the federal financial intelligence agency that is primarily responsible for investigating and prosecuting money laundering and counter-terrorism financing.
- **Reserve Bank of Australia (RBA)** - The RBA is an independent statutory body that is primarily responsible for performing Australia's central banking functions. The RBA has a range of functions, including establishing monetary policy (such as setting Australia's cash rate) and ensuring the stability of Australia's financial system.
- **Foreign Investment Review Board (FIRB)** - The FIRB is a non-statutory advisory body within the federal Treasury department. One of the key functions of the FIRB is to assess (and if thought fit, consent to) proposals by foreign persons to acquire interests in Australian land, businesses, and companies. There have been significant changes to Australia's foreign investment framework in light of the COVID-19 pandemic. It is important that foreign investors seek advice in respect of these changes when deciding whether to invest in an existing Australian company or to establish a new business operation in Australia.
- **IP Australia -** IP Australia is the federal government agency responsible for processing applications for the registration of certain registrable intellectual property rights, such as patents, trademarks, and registered designs. IP Australia has the authority to conduct hearings and determine whether to grant or refuse applications in respect of intellectual property rights.

REQUIREMENTS FOR LOCAL SHAREHOLDING/DIRECTORS

Director Requirements

Australian private companies must have at least one director who:

- is over 18 years of age;
- has not previously been disqualified from acting as a director (for example, as a result of acting as an officer of two or more companies that have gone into liquidation within the past 7 years); and
- ordinarily resides in Australia. Note the requirement for a director to "ordinarily reside" in Australia is not a question of citizenship, rather it is a question of where that person is usually domiciled.

Australian public companies must have at least three directors who satisfy the age and qualification requirements set out above, two of which must ordinarily reside in Australia.

Australian branches of foreign companies do not require a local director but must appoint at least one local agent.

Local Shareholding Requirements

There are no minimum start-up capital requirements for establishing a company in Australia. In fact, it is very common for many companies to start out as "$2 Companies", being a company with only AUD $2 in issued share capital.

Australian companies must have a minimum of one shareholder. There is no local shareholding requirement for establishing a private company

in Australia, however it is worth noting that foreign persons or entities that wish to acquire shares in established Australian companies, or interests in Australian businesses, may be required to obtain the approval of FIRB prior to such acquisition occurring.

Australia private companies must have no more than 50 shareholders (excluding any employee shareholders). Where this 50-shareholder limit is exceeded, the Corporations Act requires the company to convert to a public company.

Director's Duties

Director's duties in respect of Australian companies are largely set out in the Corporations Act, however there are some duties which derive from Australian common law. These duties include:

- **Duty of care and diligence –** Directors must act with a degree of care and diligence in performing their role as a director. The relevant level of care and diligence is measured against the expectation that a reasonable person would have of a person acting in the capacity of a company director. A director may not be liable for breach of their duty to exercise care and diligence, if it can be established that the director:
  - (a) made the relevant decision in good faith and for a proper purpose;
  - (b) reasonably 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
  - (c) made the relevant decision while having had no personal interest in the matter.
- **Duty to act honestly in good faith** – Directors must act in the best interests of the company as a whole and for a proper purpose. Broadly speaking, this duty requires a director to exercise independent judgement when acting on behalf of a company, to ensure that the best interests of the company are (objectively) paramount at all times.
- **Duty not to improperly use inside information or position –** Directors must not use their position (or any information that they gain by virtue of their position) to gain an advantage for themselves or someone else, or to the detriment of the company.
- **Duty to avoid a conflict of interest and to disclose material personal interests** – Directors must make clear disclosures to the company where the affairs or business of the company relate to matters in which the director has a material personal interest. In this regard, it is also worth noting that directors of public companies are required to obtain shareholder approval for transactions which involve their related parties and make disclosures to the market in respect of the director's personal interests.
- **Duty to avoid insolvent trading –** Directors have a duty to ensure that a company does not trade while insolvent, or when the director suspects that the company might be insolvent.
- **Duty to keep proper accounts and records** – Further to the duty to ensure that a company does not trade whilst insolvent, directors must keep themselves informed of the accounting position of the company, as well as the company's mandatory financial reporting obligations (if applicable).

Director's Liability

Given that companies are separate legal entities, in Australia company directors are generally not personally liable for the debts of the company. However, there are a number of circumstances where a director may be personally liable for a company's debt, or where a director's conduct may subject them to civil and criminal penalties, as well as damages. Examples of such circumstances include:

- **Insolvent Trading –** Directors who allow a company to trade whilst insolvent will be in breach of the Corporations Act, and in some circumstances, may be personally liable for the debts incurred by the company during the period in which the company traded whilst insolvent.
- **Personal Guarantees –** It is common for directors of small private companies to provide a personal guarantee as security for debts incurred by a company. Given that personal guarantees are a separate and binding agreement between the director and the relevant financier, a director will be personally liable for the debt to which the guarantee relates.
- **Breach of Directors' Duties** – Where a director breaches their fiduciary or statutory duties to a company as set out in the Corporations Act (and as outlined above), they may be liable for civil and criminal penalties, as well as damages in favour of the company.
- **Taxation Debts and Superannuation Contributions** – Directors can be personally liable for a company's failure to comply with their GST, Pay As You Go (PAYG) withholding tax and Superannuation Guarantee Charge (SGC) payment obligations.
- **Phoenix Activity –** "Phoenix Activity" occurs where the directors of a company place the company into liquidation or administration in order to avoid paying the company's debts, and then establish a new company for the purpose of continuing the previous company's business. Directors who engage in Phoenix Activity may be subject to civil and criminal penalties, and in extreme circumstances, may even face imprisonment.

SHAREHOLDERS' RIGHTS AND PROTECTION

Shareholders do not have the right to manage the affairs of the company. The constitution of the company usually vests the management of the company in the board of directors. Typically, the board will delegate the day-to-day operation of the company to the chief executive officer.

Shareholders have no right to demand access to information including the books of the company, under the Corporations Act. Shareholders may apply to the Court for an order to inspect the books of the company.

Shareholder Oppression under the Corporations Act

The Corporations Act provides Australian Courts with the authority to make a broad range of orders where it is established that a company has acted (or proposes to act) in a manner that:

- is contrary to the interests of the company's shareholders (as a whole); or
- is oppressive to, or unfairly prejudicial against, one or more of the company's shareholders.

Such orders can include orders that:

- require the company to be wound up;

- require the company's constitution to be modified or repealed; or
- compel or prevent a person from engaging in certain conduct.

The types of conduct which may give rise to a successful claim of shareholder oppression will be assessed by the Court on an objective basis and will involve an examination of whether the conduct would be seen as oppressive in the eyes of a reasonable person.

A common example of shareholder oppression is where a majority shareholder misuses their control and influence over the company in a way that is unfairly prejudicial to minority shareholders.

Shareholder's rights under the Corporation Act

The rights and protections that apply to shareholders under the Corporations Act will depend on the nature of the relevant company, as well as the provisions of the company's constitution and other constituent documents (such as a shareholder's agreement).

Examples of shareholder rights which are contained in the Corporations Act (and will apply to private companies, despite any contrary provision within a company's constituent documents) are set out below:

- **Amending the Constitution:** A company may only amend its constitution by passing a special resolution of members. In order to pass a special resolution, at least 75 percent of the company's shareholders must vote in favour of the proposed resolution.
- **Capital Alterations:** Companies are required to obtain shareholder approval before undertaking alterations to the company's share capital. These alterations include capital reductions, selective buybacks and share buybacks. The percentage of shareholders who must approve a proposed capital alteration will depend on the nature of the proposed alteration, and in some circumstances, may require the passing of a special resolution.
- **Right to Call Meetings of Shareholders:** Shareholders who hold at least 5% of the shares with voting rights in a company may, by written notice to the directors, demand that the directors call a meeting of shareholders. Alternatively, shareholders who hold at least 5% of the shares with voting rights in a company may call a meeting of shareholders themselves by following the notice and timing requirements set out in the Corporations Act.
- **Right to Notice of Meetings of Shareholders:** Subject to any restrictions on the rights attaching to a shareholder's shares**,** shareholders generally have the right to receive written notice of, and attend and vote at, meetings of shareholders. The Corporations Act provides that, as a general rule, at least 21 days written notice of a shareholder's meeting must be provided for private companies.

FOREIGN INVESTMENT, THIN CAPITALIZATION, RESIDENCY AND MATERIAL VISA RESTRICTIONS

Australia's Foreign Investment Framework

Relevant Legislation

Australia's foreign investment framework is set out within the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**), the *Foreign Acquisitions and Takeovers Regulations 2015* (Cth) (**Regulations**), and the Australian Federal Government's specified Foreign Investment Policy from time to time.

The FATA requires "foreign persons" or foreign government investors who propose to acquire interests in Australian real property, or certain interests in Australian companies or businesses, to obtain FIRB approval prior to such acquisition taking place.

Who is considered a Foreign Person?

The concept of a "foreign person" as set out in the FATA is far reaching and includes not only individuals who are not ordinarily resident in Australia, but will also include:

- a corporation or the trustee of a trust in which an individual not ordinarily resident in Australia, a foreign corporation or a foreign government holds a substantial interest; and
- a corporation or the trustee of a trust in which 2 or more persons, who together hold an aggregate *substantial interest*, are:
  - (a) not ordinarily resident in Australia;
  - (b) a foreign corporation; or
  - (c) a foreign government entity.

A "substantial interest" for the purposes of the above means an interest of 20% or more in the relevant company or trust.

Acquisitions of Residential and Commercial Property

There are certain restrictions imposed on the purchase of residential and commercial property by foreign persons.

Acquisitions of interests in Australian Companies and Businesses

As a general rule, foreign persons are required to obtain FIRB approval prior to entering into an unconditional agreement to acquire substantial interests (i.e., interests of 20% or more) in Australian companies or businesses which have an annual turnover above a specified threshold.

Acquisitions of interests in Australian companies by foreign government entities or in respect of Australian companies that conduct "sensitive business", such as media, telecommunications, transport, military related industries and activities and securities technologies, are subject to a very strict foreign investment approval process.

The relevant monetary thresholds which trigger the requirement of foreign investors to notify the FIRB and/or seek FIRB approval vary significantly depending on the characteristics of the target entity or business, and generally apply to businesses or companies which are valued at more than $281 million AUD.

Importantly, there have been significant changes to Australia's foreign investment framework as a result of the COVID-19 pandemic. Any person or entity seeking to invest in Australian land or companies should seek legal advice regarding the relevant FIRB approvals which must be obtained.

The overarching policy objective behind the FIRB's regulation of foreign investment into Australian companies and businesses is to ensure that any proposed foreign acquisitions are not contrary to Australia's national interest.

Capitalization Obligations

In Australia, "thin capitalization" rules apply to:

- **"Outward investing entities"** – being Australian entities with specified overseas investments; and
- **"Inward investing entities"** – which are foreign entities with certain investments in Australia, regardless of whether they hold the investments directly or through Australian entities.

One of the key objectives of the thin capitalization rules is to ensure that inward and outward investing entities fund their Australian operations with a sufficient amount of equity capital. This is achieved by limiting the debt deductions that inward and outward investing entities are able to claim in their annual tax returns, which would otherwise have the effect of minimizing their Australian taxation liabilities.

The thin capitalization rules can change from year to year and will only apply when an entity's debt-to-equity ratio exceeds the allowable limits. Foreign entities which conduct business operations in Australia should seek independent taxation advice in respect of the thin capitalization rules.

Business or Investment Visas

Migration to Australia is primarily governed by the *Migration Act 1958* (Cth) (**Migration Act**) and the *Migration Regulations 1958* (Cth) (**Migration Regulations**). Non-Australian persons generally have a right to travel to, enter, and remain in Australia provided that they obtain an appropriate class of visa and complete the immigration clearance process.

There are a broad range of visas that are available for foreign persons who wish to seek employment or commence business operations in Australia. These visa classes include:

- **Subclass 188 - Business Innovation and Investment (Provisional) visas**

  A Subclass 188 Visa allows foreign persons to own, manage and conduct businesses and to conduct investment or entrepreneurial activities in Australia. A Subclass 188 Visa is generally valid for 4 years and 3 months, however provisional visa holders may be able to apply for a permanent visa once certain requirements are met.

- **Subclass 132 - Business Talent (Permanent) visas**

  A Subclass 132 Visa allows foreign persons to establish a new (or develop an existing) business in Australia, and to then remain in the country permanently. Persons who are eligible to apply for a Subclass 132 Visa must meet specific business experience, net asset holdings and/or venture capital criteria.

- **Subclass 400 - Temporary Work (Short Stay Specialist) visa**

  A Subclass 400 Visa allows for foreign persons to enter and remain in Australia for the purposes of performing short-term, highly specialised work. In order to be eligible for a Subclass 400 Visa, the applicant will be required to have specialised skills, knowledge or experience that is not commonly available in Australia. A Subclass 400 Visa can be granted for up to 6 months; however, applications for more than 3 months must be supported by a strong business case.

- **Subclass 482 - Temporary Skill Shortage visa**

  A Subclass 482 Visa allows Australian businesses to sponsor a suitably skilled foreign person to work in their business if they are unable to source an appropriately skilled Australian worker. Subclass 482 Visas are generally valid for a period of 2 years; however, they may be granted for up to 4 years if an International Trade Obligation applies.

Foreign persons who wish to enter Australia for the purpose of seeking employment or commencing business operations in Australia should seek the advice of a registered Migration Agent, who will be able to provide

advice in respect of the appropriate class of visa and the associated application process.

Restrictions on Remitting Funds out of Australia

The general position is that there are no restrictions on the amount of funds (including cash and electronically transmitted funds) that may be transferred in or out of Australia. However, the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (**AML/CTF Act**) requires certain transactions to be reported to AUSTRAC within 10 days of such transfer occurring, for the purpose of detecting tax evasion and money laundering.

The AML/CTF Act imposes additional regulatory requirements on businesses that are classified as "reporting entities". Reporting entities are entities which provide "designated services", including financial, gambling, bullion, or digital currency exchange services.

At a high level, the AML/CFT Act requires reporting entities to:

- implement an AML/CTF compliance program, which includes verifying the identity of clients before a designated service is provided, and collecting and verifying information about beneficial owners of clients;
- report specific kinds of transactions and suspicious matters to AUSTRAC; and

keep accurate records in respect of their customers.

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INTERNATIONAL LAWYERS NETWORK

BRAUNEIS KLAUSER PRÄNDL

ESTABLISHING A BUSINESS ENTITY IN AUSTRIA

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN AUSTRIA

1. Introduction

In principle any national citizen or foreign national is allowed to establish a business in Austria. A company is defined as a partnership of at least two persons (exceptions for limited liability companies and joint-stock companies), founded by a legal transaction, who want to achieve a certain purpose through organized cooperation. While one person is sufficient to establish a **limited company** (*Kapitalgesellschaft*), at least two persons are necessary to form a **partnership entity** (*Personengesellschaft*). A business operated by a single natural person with full personal liability (i.e., without any further partners or shareholders) is referred to as a **sole proprietorship** (*Einzelunternehmen*).

If foreign business owners choose to establish a subsidiary in form of a limited company in Austria it is important to mention that the establishment is legally independent from the parent company meaning that the foreign parent company does not bear direct and unlimited liability for the subsidiary's obligations. The corporate forms typically chosen for such subsidiaries are the **limited liability company** (**GmbH**) and the **joint-stock company** (**AG**). Additionally, there is the **European Company** (**SE**), which is seldom used.

With regard to partnership entities, the **general partnership** (**OG**) and the **limited partnership** (**KG**) may be used. Another option to choose is the so-called **GmbH & Co KG**, which is a hybrid form of a limited company and a partnership entity that combines characteristics of each of those two.

2. Types of business entities

Austrian company law offers a limited number of possible corporate forms, which are conclusively regulated by law. No further company forms may be created (however, companies incorporated in a Member State of the EU or EEA must be recognized as such in Austria). The most important Austrian company forms are:

- Limited liability company or Gesellschaft mit beschränkter Haftung (**GmbH**)
- Joint-stock company or Aktiengesellschaft (**AG**)
- European Company or Societas Europaea (**SE**)
- General Partnership or Offene Gesellschaft (**OG**)
- Limited partnership or Kommanditgesellschaft (**KG**)
- Branch offices of foreign companies or Zweigniederlassung

2.1 Limited liability company (GmbH)

The limited liability company or *Gesellschaft mit beschränkter Haftung* (**GmbH**) is an incorporated entity and is among the most popular legal forms for business enterprises in Austria. Its legal identity is independent of that of its shareholders. As a general rule, the shareholders of a limited liability company do not bear any personal liability towards the company's creditors for the company's obligations ("principle of separation"). The shareholders of a **GmbH** are only personally liable for unpaid share capital, or in the case of malevolence of the shareholder.

A **GmbH** is set up by one or more shareholders, who may be individuals, corporations and partnerships, residents and non-residents, Austrian and foreign citizens, as well as foreign corporations.

The contract between two or more founders of a limited liability company is called

Articles of Association (*Gesellschaftsvertrag*). In case of a sole-shareholder company, the articles are referred to as Declaration of Establishment (*Errichtungserklärung*). Both documents must be certified by a notary public by means of a notarial deed. The *Gesellschaft mit beschränkter Haftung* (**GmbH**) comes into legal existence upon its registration in the Commercial Register (*Firmenbuch*). The minimum share capital of a limited liability company is EUR 35,000. At least half of the share capital (EUR 17,500) must be paid in cash (exception: continuation of an enterprise and contributions in kind). If the founders make use of the so-called Formation Privilege (*Gründungsprivilegierung*), only EUR 5,000 must be paid in cash at the time of formation. Additionally, the shareholders are personally liable for another EUR 5,000 during the first ten years after the "privileged formation" of a **GmbH** has been registered in the Commercial Register (*Firmenbuch*). The Formation Privilege (*Gründungsprivilegierung*) ends after ten years at the latest but can also be discontinued voluntarily at an earlier point in time. The requirements for this step are that the Articles of Association are amended accordingly and that the statutory minimum deposit requirements (usually at least EUR 17,500 in cash) are met. Since the transfer of shares in a **GmbH** is more difficult (a notarial deed is required) than that of stock in a stock company (**AG**) the **GmbH** is less suitable if a widespread ownership or the frequent transfer of shares is desired.

2.2 Joint-stock company (AG)

The joint-stock company or *Aktiengesellschaft* (**AG**) is similar to the *Gesellschaft mit beschränkter Haftung* (**GmbH**) and the second legal form of a limited company in Austria. The *Aktiengesellschaft* (**AG**) is an independent legal entity and possesses rights and obligations of its own. The shareholders of an **AG** are only personally liable for unpaid share capital, or in the case of malevolence of the shareholder.

In comparison to the **GmbH**, the establishment of a joint-stock company is more complicated and more expensive.

An **AG** may be set up by one or more natural persons or legal entities. In the case of a sole founder, it is required to register the sole- shareholder's name in the Commercial Register (*Firmenbuch*). The Articles of Association must be certified by a public notary by means of a notarial deed. The formation procedure is subject to stricter formal requirements compared to the **GmbH**. The minimum stock capital of an *Aktiengesellschaft* (**AG**) is EUR 70,000. At least one quarter of said amount must be paid in during the company's formation. The **AG** comes into legal existence upon its registration in the Commercial Register (*Firmenbuch*).

In comparison to the **GmbH,** the **AG** is structured after a so-called dualistic model. This means that the General Meeting (*Hauptversammlung*) appoints a Supervisory Board (*Aufsichtsrat*) with at least 3 members and the Supervisory Board appoints the Board of Directors (*Vorstand*). The directors are appointed for a maximum term of 5 years but may be reappointed after their term has ended. Contrary to the managing directors of a **GmbH**, members of the Board of Directors (*Vorstand*) of a joint-stock company (**AG**) are not subject to instructions by the General Meeting or the Supervisory Board in their normal course of business.

The most significant advantage of the *Aktiengesellschaft* (**AG**) compared to the **GmbH** is the easier transferability of company shares and their tradability on the stock market.

2.3 Entities under European Law (SE)

The European Company or *Societas Europea* (**SE**), the *European Cooperative Society* (**SCE**) and the *European Economic Interest Grouping* (**EEIG**) are also business entities which may be incorporated under Austrian law but are seldom used.

2.4 General Partnership (OG)

The general partnership or *Offene Gesellschaft* (**OG**) is an association of at least two physical persons or legal entities. Each of the partners in a general partnership bears personal, unlimited, direct, and joint liability for all the partnership's obligations. The liability towards creditors can't be limited. The general partnership may be established for any purpose permitted by law and may therefore undertake all commercial, industrial, professional, and agricultural activities (exceptions: activities such as insurance businesses, pension funds and employee provision funds). Unlike limited companies, the *Offene Gesellschaft* (**OG**) may be set up without any initial capital. It comes into legal existence upon its registration in the Commercial Register (*Firmenbuch*).

2.5 Limited Partnership (KG)

2.5.1 General information

The limited partnership or *Kommandit-gesellschaft* (**KG**) is a partnership entity consisting of at least two physical persons or legal entities, similar to the *Offene Gesellschaft* (**OG**). The major difference towards the **OG** is the liability of its members, because not all the partners bear full and unlimited liability for the partnership's obligations. At least one partner ("general partner") is required to bear unlimited liability for the partnership's obligations while the remaining partner/s ("limited partner") is/are only liable up to the amount of their capital contributions registered in the Commercial Register (*Firmenbuch*).

2.5.2 GmbH & Co KG

The **GmbH & Co KG** is a hybrid form of the limited liability company (**GmbH**) and the limited partnership (**KG**) in which the sole personally liable general partner is a limited liability company (**GmbH**). In a typical setup the shareholders of the **GmbH** are also limited partners of the **KG**.

Considering how the liability of the partners is modified in case of the **GmbH & Co KG** the Austrian legislation tends – due to the strict rules on creditor protection – to apply the same legal framework to the **GmbH & Co KG** as to the limited liability company (**GmbH**). Therefore, the **GmbH & Co KG** is sometimes referred to as "hidden limited company".

The reasons for establishing this special form of a limited partnership are motivated mainly by the advantages of an indirect limitation of liability and tax benefits.

2.6 Branch offices of foreign companies

Foreign legal entities (i.e., sole proprietors, partnership entities and limited companies) may do business in Austria by establishing so-called branch offices (*Zweigniederlassungen*). This possibility is available to every foreign legal entity, also business entities from non- European countries.

Although branch offices (*Zweigniederlassungen*) of foreign legal entities are required to be registered in the Commercial Register (*Firmenbuch*), they do not enjoy a separate legal personality. All obligations and liabilities of the branch office (*Zweigniederlassung*) constitute obligations of the respective foreign legal entity (business owner).

If a branch office (*Zweigniederlassung*) is established for a foreign limited liability company or joint-stock company with its registered seat outside the EU/EEA, it is required to appoint a "permanent representative" for the Austrian branch. The "permanent representative" is obliged to have his ordinary/main residence in Austria.

3. Steps and Timing to Establish

The necessary steps to establish any company form in Austria are similar in many ways, but there are a few differences for each type of business entity.

The principal step of any formation proceeding is the conclusion of the so-called Articles of Association (*Gesellschaftsvertrag*) which determine inter alia the name, the seat of the company, its purpose as well as the rules governing the interaction of its shareholders. The company's name must be suitable for its identification and must have a distinctive character. As already mentioned, for the foundation of a limited liability company and a joint-stock company a notarial deed is required. All applications to the Commercial Register (*Firmenbuch*) must be notarized.

The limited liability company demands a minimal amount of stock capital of EUR 35,000 (in the case of a Privileged Formation, EUR 10,000) and the joint-stock company EUR 70,000. Furthermore, there are certain criteria as to how the stock capital must be composed.

Generally, a company comes into legal existence upon its registration in the Commercial Register (*Firmenbuch*). Sole proprietorships do not have to be registered unless they exceed a certain business turnover of more than EUR 700,000 in two consecutive years or more than EUR 1.000,000 in one year.

Insurance Requirements:

Within the first month the managing directors (*Geschäftsführer*) (**GmbH**) or partners (**OG, KG**) must be registered with the Commercial Social Insurance Fund. Before employing anyone, a notification must be sent to the Regional Medical Insurance Company (*Gebietskrankenkasse*). Also, within the first month the commercial activity must be reported to the local fiscal authorities to receive a taxpayer identification number.

Required documents for a limited liability company:

The following documents must be presented to the Commercial Register (*Firmenbuch*) for the incorporation of a limited liability company (**GmbH**):

- Application for registration in the Commercial Register (*Firmenbuch*)
- Articles of Association (*Gesellschaftsvertrag*)
- Shareholder resolution on the appointment of at least one managing director (*Geschäftsführer*)
- Notarized signature specimen of the managing directors (*Geschäftsführer*) and other authorised representatives (*Prokuristen*)
- Bank confirmation that the initial contributions have been paid into the agreed amount in cash and that they are at the free disposal of the managing directors (*Geschäftsführer*) and are

especially not limited by any claims

- Resolution of the shareholders in notarized form regarding the election of the Supervisory Board (*Aufsichtsrat*) (if applicable)
- Resolution of the Supervisory Board (*Aufsichtsrat*) regarding the election of a chairman and the deputy chairman (if applicable)

4. Governance, regulation, and on-going maintenance

4.1. Corporate governance

Corporate governance of course varies by the type of the company. For limited companies, the supreme body is the General Meeting: the so- called *Generalversammlung* for the **GmbH** and the so-called *Hauptversammlung* for the **AG**.

A limited liability company (**GmbH**) is obliged to have a General Meeting (*Generalversammlung*) and one or more managing directors (and in some cases a Supervisory Board (*Aufsichtsrat*), which may also be established voluntarily). Managing directors (*Geschäftsführer*) must act with due diligence and follow the principle resolutions passed by the company's general meeting in compliance with the Articles of Association of the company and the applicable laws. They must not disclose sensitive and confidential information to third parties, and they may be held personally liable for all damages caused by breaches of these obligations. Moreover, they usually must abide to a non-competition clause, which is normally part of their employment contract.

As already mentioned, for joint-stock companies (**AG**) a dualistic model is compulsory. This means that the General Meeting (*Hauptversammlung*) appoints a Supervisory Board (*Aufsichtsrat*) with at least 3 members and the Supervisory Board appoints the Board of Directors (*Vorstand*). The directors are appointed for a maximum term of 5 years but may be reappointed after their term has ended. Contrary to the managing directors of a **GmbH**, members of the Board of Directors (*Vorstand*) of a joint-stock company (**AG**) are not subject to instructions by the General Meeting or the Supervisory Board in their normal course of business. The Board of Directors (*Vorstand*) must also prepare the financial statements, which must be approved by the Supervisory Board (*Aufsichtsrat*) and then presented to the General Meeting (*Hauptversammlung*).

4.2 Audit requirements

In the first five months of the financial year, limited companies (**GmbH, AG**) and hidden limited companies (**GmbH & Co KG**) must prepare and submit the annual financial statements, together with the accompanying notes, a management report and, if applicable, a corporate governance report (e.g., large joint-stock companies) and a report on payments to government agencies for the preceding financial year, to the members of the Supervisory Board (*Aufsichtsrat*) (if there is one).

In the following cases a statuary audit is mandatory:

- Joint-stock companies (**AG**)
- Banks, insurance companies and investment funds
- Large and medium sized limited liability companies (**GmbH**)

In comparison, small and very small companies are only obliged to submit limited financial information to the Commercial Register (*Firmenbuch*).

A company is considered small if at least two of the following criteria are met:

- Total assets are lower than EUR 5 million
- Turnover is below EUR 10 million
- Average number of employees is less than 50

A company is considered medium-sized if at least two of the following criteria are met:

- Total assets are between EUR 5 million and 10 million
- Turnover is between EUR 10 million and 40 million
- Average number of employees is between 50 and 250

A company is considered large if two of the above-mentioned criteria are exceeded (total assets exceed EUR 10 million, turnover exceeds EUR 40 million and average number of employees exceeds 250).

4.3 Minority shareholder rights and protection

The rights of minority shareholders shall be explained in this chapter on the basis of the legal framework regarding the limited liability company (**GmbH**).

Shareholders are entitled to the following minority rights, depending on the percentage of equity held:

- Shareholders who hold at least one third of the share capital alone or jointly may appoint a minority representative to the Supervisory Board (*Aufsichtsrat*).
- Shareholders whose capital contributions amount to (i) 10% of the share capital or (ii) the nominal amount of EUR 700,000 or (iii) a lower amount stipulated in the Articles of Association (*Gesellschaftsvertrag*) alone or jointly are entitled to the following minority rights:
  - Appointment of an expert for a special audit of the annual financial statements;
  - Assertion of claims to which the company is entitled against shareholders, managing directors (*Geschäftsführer*) and members of the Supervisory Board (*Aufsichtsrat*);
  - Appointment and dismissal of liquidators for cause.
- Shareholders who hold at least 5% of the share capital or the proportionate amount of EUR 350,000 alone or jointly have the following minority rights:
  - Appointment of auditors;
  - Audit of the annual financial statements during liquidation.

Further minority rights result from the majority requirements for shareholder resolutions. Resolutions which require a majority of three quarters of the cast votes, e.g., amendments to the Articles of Association (*Gesellschaftsvertrag*), can be prevented by more than 25% of the cast votes (blocking minority).

It may be noted that the rights of minority shareholders in joint-stock companies (**AG**) are like the aforementioned rights in the limited liability company (**GmbH**).

5. Employment Law

5.1. Employment of foreign citizens

The employment of foreign citizens is subject to various restrictions and controls under the Employment of Foreign Citizens Act (*Ausländerbeschäftigungsgesetz*, **AuslBG**), which forms the basis for the access of foreign workers to the Austrian labour market.

The **AuslBG** aims to regulate the ordered access of foreign workers to the Austrian labour market and ensures that they are employed under proper working conditions and wages.

Employment of EU/EEA Nationals: For nationals of EEA member states and Switzerland (with exceptions currently still in place for Croatia until 30/06/2020), the rules of free movement of workers apply substantially in the same way as for citizens of EU member states. EU/EEA nationals have free access to the Austrian labour market according to EU law and require no employment or working permit. EU/EEA citizens who wish to stay longer than three months in Austria only need a registration certificate. This is issued by the competent residence authority.

Employment of Non-EU/EEA Nationals: According to the **AuslBG** workers from third countries (non-EU/EEA countries) require – as mentioned above – a combined work and residence permit to be granted long- term access to the labour market in Austria. Such a permit enables them to work for a specific employer (e.g., with a so- called *Rot-Weiß-Rot-Karte*) or grants free access to the labour market (e.g., with a so-called *Rot-Weiß-Rot-Karte Plus*). It can be noted here that issuing such a work visa is made easier if a highly qualified and well-paid worker is to be recruited.

6. Taxation

The tax burden on corporate profits in Austria depends on the legal form of the company, the amount of profit generated and lastly on whether the profit is distributed or withdrawn by the shareholders or not.

6.1 Income tax and corporate income tax

Austrian tax law knows two different income taxes: income tax (*Einkommenssteuer*, **ESt**) and corporate income tax (*Körperschaftssteuer*, **KÖSt**). While the income tax (**ESt**) for individuals is designed as a progressive tax-system depending on the actual amount of income, the corporate income tax (**KÖSt**) is set uniformly at 25% of the taxable income or, in the case of limited liability, at 25% of the taxable income earned within Austria. A current tax reform will gradually reduce the corporate income tax (**KÖSt**) to 23% over to course of two years beginning in 2023 (1% from January 1, 2023, 1% from January 1, 2024). Legal entities that fall under the corporate income tax are limited companies (most notably **GmbH** and **AG**), institutions and foundations, but also regional authorities and professional bodies (e.g., Chamber of Commerce). In contrast to other EU countries, there are no other taxes on the profit (e.g., a trade tax).

Losses may be carried forward indefinitely. In each subsequent profit year, only 75% of the profit may be compensated. This means that 25% of the profit is taxable even with existing loss carryforwards.

Branches of foreign companies are also subject to Austrian corporate income tax (**KÖSt**) with their income earned in Austria.

6.2 Group taxation

Austria has a modern group taxation system, which allows compensation of profit and loss within a group. Even foreign entities may be part of this system.

Austrian group taxation has the effect of balancing the profits and losses of the parent company and its subsidiaries by forming a group of companies. The group parent then combines the results of the group members and subjects them to taxation.

The requirements for the eligibility of the group taxation are:

- Capital participation (share capital, share capital or cooperative capital) of more than 50% and majority of voting rights of the group parent in the group members (financial link);
- Submission of a group application to the tax authority;
- Conclusion of a group agreement for the purpose of tax equalization within the group;
- Financial link during the entire financial year and/or retention in the group for at least 3 years.

6.3 Tax relief and international box participation

In general, taxation of foreign income is based on the provisions for avoiding double taxation. The so-called international box participation (*Schachtelbegünstigung*) is an objective tax exemption within the framework of the corporate income tax (**KÖSt**) for distribution and capital gains from certain participations in foreign corporations. The goal of the regulation is to ensure that profits earned by corporations are taxed only once, as long as they do not flow to natural persons.

The rules for an international box participation apply if

- an Austrian parent company
- has a share of at least 10%
- in a foreign subsidiary (that is like an Austrian company)
- for an uninterrupted period of at least one year.

In the case of an international box participation, profit distributions of the foreign subsidiary to the Austrian parent company are tax-free.

6.4 Capital gains tax

Capital gains tax (*Kapitalertragsteuer*, **KESt**) is a special form of income tax. In the case of domestic income from capital assets, this income tax is levied by withholding tax. This means that the capital gains tax is withheld by the bank or the paying agent and paid directly to the tax office.

Capital gains tax of 25% is imposed on investment income from cash deposits (e.g., for interest on savings books and current accounts). For all other income from capital assets, the tax rate is 27.5% (e.g., for dividends from shares in limited companies).

Capital gains of a company are fully included in the taxable income and are taxed at the corporate income tax rate of 25%. Capital gains on sales of shares in foreign companies are exempt from Austrian income tax under certain circumstances.

This Memorandum is for information purposes only and reflects Austrian law in December 2021.

This Memorandum does not constitute legal advice and cannot replace personal consultation on a case-by-case basis. If you have any further questions about establishing a business in Austria or need general legal advice, please contact Mr Andreas Bauer, a.bauer@bkp.at, +43 1 532 12 10.

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ESTABLISHING A BUSINESS ENTITY IN BRAZIL

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN BRAZIL

The two most common forms of legal entities incorporated in Brazil are the limited liability company ("Limitada") and the corporation ("S.A."). These are considered the most attractive types of companies given that they are the only entity types which both have the following advantages in common: (i) the liability of the equity holders is generally limited to their equity interest (subject to certain specificities described below); (ii) either can be utilized for any type of business activity (e.g. services, industry, commerce etc.); and (iii) generally speaking, neither has any minimum capital requirements (and when required, is by virtue of their activities carried out and not associated with their particular corporate type).

1. Recent updates to Brazilian Corporate Laws.

In recent years, Brazilian corporate laws have undergone several changes with the aim to improve and modernize the country´s business environment.[2]

Some of the notable changes are the following innovations:

- a Limitada can now be held by only one partner (individual or legal entity);
- digital and remote general meetings for both Limitada and S.A. are now governed by express legal provisions;
- introduction of plural vote for S.A.;
- non-residents may now be elected as officers/managers, provided they are represented by a Brazilian resident for the purpose of receiving service of process;
- no more need to include a Limitada's main activity in its name;
- possibility to appoint only one officer in a S.A. (similarly to a Limitada);
- replacement of corporate books by electronic corporate books;
- possibility to issue preferred quotas in Limitadas, without voting rights (although this matter is still under academic debate); and
- extinction of the corporate type known as "Eireli", a type of Limitada with one sole partner that became obsolete since all Limitadas are now allowed to be held by only one partner.

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

The Limitada is governed by the provisions of the Brazilian Civil Code, law 10,406/02 (the "Civil Code"), as amended, and the S.A. is governed by the Corporation Law, law 6,404/76 (the "Corporation Law"), as amended. The Articles of Association of a Limitada may state that the company is subsidiarily governed by the Corporation Law, in which case the latter will apply whenever the Civil Code is silent on any aspect.

A S.A. may be either publicly or closely held. A publicly held S.A. must be registered with the

[2] Within this framework, Law 13,874 enacted on September 20, 2019 ("Law of Economic Freedom"), Law 14,030 enacted on June 28, 2020, Supplementary Law 182 enacted on June 1, 2021 ("Startup's Legal Framework"), Law 14,195 enacted on August 26, 2021 ("Law of Business Environment") along with some regulatory changes were put into operation by the Brazilian National Department of Companies' Registration and Integration through its regulations ("DREI").

Brazilian Securities and Exchange Commission ("CVM") for purposes of having its stocks traded in the Stock Exchange. A closely held S.A., as the name suggests, is a private entity, which does not issue shares to the public. For purposes of this article, only the characteristics of a closely held S.A. are to be considered.

Since the S.A. was conceived to be the type of entity aimed at more substantial ventures, it is subject to more rigorous regulation. Given its nature, the S.A. is less adaptable and suitable to customization and tend to be too bureaucratic in some instances. However, it is important to acknowledge that the Startup's Legal Framework has reduced some of the burden and bureaucracy for closely held corporations with gross revenue of up to BRL 78,000,000.00, such as the requirement for publication of corporate acts.

By contrast, the principal strength of a Limitada lies in its flexibility and customization characteristics being subject to less regulation and bureaucracy compared to the S.A. It follows that the Limitada is by far the most popular type of corporate entity in Brazil. There are currently more than 4 million active Limitadas compared to the less than 200,000 active S.A. What makes this difference even more remarkable is that this number does not take into account the 1 million Eirelis that will be converted into Limitadas pursuant to the recent enactment of the Law of Business Environment[3].

The tables below delineate and compare the most relevant characteristics and the basic differences between a Limitada and a S.A.

[3] Information available on DREI's website: https://www.gov.br/governodigital/pt-br/mapa-de-empresas/painel-mapa-de-empresas

COMPARATIVE CHART BETWEEN BRAZILIAN LIMITADAS AND S.A.

A. General Aspects

In general, the main differences between a Limitada (with one or more partners) and a S.A. are the following:

	LIMITADA	S.A.
Holders/Owners	Holders of the Limitada are called partners/quotaholders *(sócios/quotistas).*	Holders of the S.A. are called shareholders/stockholders (*acionistas*).
Name	The Limitada may have any name followed by the wording "Ltda."	The company may have any name followed by the wording "S.A.".
Minimum Holders	One or more partners/quotaholders.	Minimum of two shareholders/stockholders.
Governing Documents	The Limitada is governed by the Articles of Association ("*Contrato Social"*).	The S.A. is governed by the By-laws ("*Estatuto Social*").
Capital Stock / Quotas/Shares	Capital is divided into quotas, as stipulated in the Articles of Association. All quotas must have voting rights and an indicated par value. There may be preferred quotas but there is a debate whether they can exclude voting rights, as by law all quotas must have voting rights[4].	Capital is divided into shares, which ownership is reflected in the company's corporate books, and may also be represented by certificates (although no longer common). There may be preferred shares with no or limited voting rights, and there may be shares with or without a par value.
Plural Vote	Not allowed.	A plural vote may be established in both publicly and closely held S.A., being a maximum of 10 votes per each share, with an initial term limited to 7 years. This initial term may be renewed for any time, provided that a minimum quorum is observed. Shareholders that do not agree with the deliberation for the adoption of plural vote are entitled to withdrawal from the company, upon receipt of the value of their shares.
Transfer of Interest	Articles of Association must be amended for the quotas to be transferred. Transfer of quotas to a third party may be opposed by partners representing more than ¼ of the capital stock, if not otherwise established in the Articles of Association.	Transfers of shares are registered in the company's corporate books. No need to amend the By-laws.

[4] As of October 2021, pursuant to DREI's Normative Ruling No. 81, Limitadas may issue preferred quotas without voting rights, although the Civil Code stipulates otherwise.

	LIMITADA	S.A.
Securities	Limitada may not issue debentures, warrants, other securities, or convertible bonds, but may issue commercial notes.	The S.A. may issue debentures, warrants and other convertible bonds (as may a closely held S.A., i.e., no need to be publicly held).
Minimum Capital	No minimum capital must be paid in at the time of formation of the Limitada.	10% of the subscribed capital must be paid in at the time of incorporation of the S.A.
Dividends	No minimum dividend payment required. Payment of dividends may be in proportion to the partners' equity interest or not.	A minimum dividend should be stipulated in the By-laws, except for closely held companies with total annual revenue of up to BRL 78,000,000.00 in which such minimum dividend may be established at any time. Payment of dividends must be in proportion to the shareholders' equity interest.
Management	At least 1 individual, without restrictions applicable to foreigners and/or non-residents. Non-residents of Brazil must be represented by a Brazilian resident for purposes of receiving service of process.	At least 1 individual, without restrictions applicable to foreigners and/or non-residents. Non-residents of Brazil must be represented by a Brazilian resident for purposes of receiving service of process.
Publication	No need to publish financial statements and corporate acts in newspapers, unless the Limitada is considered a "large size company" (refer to details below)[5].	Publication of financial statements and corporate acts in newspapers is required, except for closely held companies with total annual revenue of up to BRL 78,000,000.00, in which case the relevant documentation may be made published in electronic format on a digital platform maintained by the Federal Government.

B. Partners/Shareholders and Capital Stock

	LIMITADA	S.A.
Partners/ Shareholders	May be incorporated by 1 or more partners, individuals, or legal entities, whether Brazilian or foreign. The foreign partners must be represented by a Brazilian resident and are required to obtain a taxpayer registration number. For the representation in	Minimum of 2 shareholders required, whether individuals or legal entities, Brazilian or foreign. As for representation, foreign shareholders may be represented by another shareholder, an officer, or a lawyer, all of whom to be residents in Brazil[6].

[5] There is a debate about whether Limitadas that are considered "large size companies" should be required to publish their financial statements.

[6] Exceptionally, a S.A. may also have only one shareholder, in which case, however, must comply with certain requirements, such as being incorporated by public deed and having a Brazilian company as its sole shareholder, or being converted into a wholly owned subsidiary through the acquisition of all its shares by a Brazilian company.

	LIMITADA	S.A.
	meetings or assemblies, the Brazilian resident must either be one of the other partners or a lawyer.	
Liability	Until the capital is not 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 is fully paid in.
New Partners/ Shareholders	The admission of a new partner may be opposed by partners representing more than ¼ of the capital stock, if not otherwise established in the Articles of Association. In addition, the Articles of Association or a partners' agreement may impose limitations and/or preference rights for the transfer and sale of quotas.	The By-laws or a shareholders' agreement may impose limitations and/or establish preference rights for the sale of shares.
Capital Contribution	May be paid in cash (in the national currency), credits or assets.	The same as with the Limitada, but the payment of capital through assets require a valuation of the assets and an appraisal report prepared by a specialized firm or 3 experts.
Capital Increase/ Preemptive Rights	Only possible if 100% of the capital is fully paid in. Partners have a preemptive right to subscribe to new quotas, pro-rata to their equity interest.	Only permitted after ¾ of the capital stock is paid in. Shareholders have a preemptive right to subscribe new shares, pro-rata to their equity interest.
Amendments to the governing documents	The following actions, among others, require the amendment of the Limitada's Articles of Association, subject to approval by partners that hold 75% of the capital: • change of the corporate name, address, purposes, or duration • changes to the capital stock (increase or reduction) • changes to management provisions • super majority requirements	The same as with the Limitada, but changes to the By-laws require approval of shareholders representing more than 50% of the total votes granted by virtue of voting stocks.

C. Management

	LIMITADA	S.A.
Structure	Minimum of 1 manager. Although optional, it is very uncommon to have Board of Directors in a Limitada.	Board of Officers with at least 1 member (mandatory). May also have a Board of Directors with at least 3 members.
Characteristics of Managers	Managers may be partners or non-partners and may be foreigners and/or non-residents (no nationality requirement). The foreign Manager must be represented by a Brazilian resident for purposes of receiving service of process and relevant power of attorney must be valid for 3 years following the date on which the Manager ceases to be a Manager of the Limitada.	Members of the Board of Officers and Board of Directors may be foreigners and/or non-residents (no nationality requirement). The foreign Officers/Directors must be represented by a Brazilian resident for purposes of receiving service of process and relevant power of attorney must be valid for 3 years following the date on which the Officer/Director ceases to be an Officer/Director of the S.A.
Board of Directors	There are no specific requirements for a Board of Directors in a Limitada and it is uncommon for it to have this type of board. If provided for in the Articles of Association, such a board may have a "consulting" function without management powers.	In general, not required, but if formed, the Board has a more "robust" purpose, with exclusive functions assigned by law such as general supervision, planning and powers to elect the members of the Board of Officers. Only one third of the members of the Board of Directors may simultaneously be members of the Board of Officers.
Reserved Matters	Certain reserved matters (such as spin-offs, mergers, liquidation, etc.) depend on the approval of the partners. Additional limitations to management's authority may be adopted and incorporated into the Articles of Association.	Certain reserved matters (such as spin-offs, mergers, liquidation, etc.) must be submitted for consideration of and decision by the Board of Directors (if one exists) and the Shareholders Meeting. Additional limitations to management's authority may be adopted and incorporated into the By-laws.
Election	Managers are always elected by the partners.	The members of the Board of Officers are elected by the Board of Directors (if one exists), or directly by the shareholders. The members of the Board of Directors are always elected by the shareholders.
Supervisory Board	Not mandatory. It may be provided for in the Articles of Association, in which case must comprise 3 or more members and their substitutes. 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 whether it will be convened or not. When convened, the Supervisory Board must comprise 3 to 5 members, who may or not be shareholders, cannot be an officer nor a director, and must be Brazilian residents (no nationality requirement).

D. Other Characteristics

	LIMITADA	S.A.
Partners'/ Shareholders' Meetings Quorum	The most important decisions require a quorum of ¾ (75%) of the capital stock (for instance amendments to the Articles of Association, capital contributions, changing the corporate purposes, amalgamation, merger, dissolution, or termination or liquidation of the company). Other decisions, such as approval of the financial statements, may be approved by a majority vote. Articles of Association and partners agreement may require super majority decisions.	Decisions taken by majority vote. The By-laws and shareholders agreement may require super majority decisions.
Meetings' Calls	The Articles of Association may establish its own procedure to convene the partners' meetings, except if the company has more than 10 partners, in which case the call notices must be published 3 times 8 days in advance for the first call, and 5 days in the event of a second call. The requirement for a meetings´ call may be waived if all partners attend the meeting.	Call notices for shareholder meetings must be published 3 times 8 days in advance for the first call, and 5 days in the event of a second call. The requirement for a meetings´ call may be waived if all shareholders attend the meeting.
Publishing Requirements	In the interim, the need to publish financial statements is under discussion. There is ongoing debate whether Limitadas, which are considered "large size companies", should be required to publish their financial statements. "Large size companies", in terms of its legal definition, is a company or group of companies under common control that held, in the previous fiscal year, total assets exceeding BRL 240,000,000.00 or annual gross revenues exceeding BRL 300,000,000.00. A Limitada that does not meet these criteria, is not required to publish the financial statements. Minutes of partners' meetings or the articles of association are not published, except in specific cases such as in the event of mergers, spin-offs, capital reductions and conversion into another corporate type.	Financial statements and corporate acts must be published in the Official Gazette and a newspaper with wide circulation. A closely held S.A. with a total annual revenue of up to BRL 78,000,000.00 can publish its financial statements and other documents in relation to the company's administration in electronic format on a digital platform maintained by the Federal Government
Audited Financial Statements	Only required for "large size companies", as defined above.	Only required for (i) publicly held, and (ii) "large size companies" as defined above.

3. Necessary Information

The formation documents of Brazilian entities must contain the following information:

(a) Partners/Shareholders. Name and identification of the partners/shareholders. Foreign partners/shareholders need to obtain a taxpayer registration number in Brazil (a straightforward procedure).

(b) Name of the Company. Although DREI's Normative Instruction No. 81, issued on June 10th, 2020, does not require that the company's main activity be included in its name, in practice the application of this requirement is subject to the interpretation of the respective Boards of Commerce in each jurisdiction.

(c) Purposes of the Company. Aspects relating to taxation should be considered when specifying the activities to be carried out by the company.

(d) Complete Address. The full address of the head office and branches (if any) must be provided.

(e) Term of Duration. May be either determinate or indeterminate.

(f) Capital Stock. Amount of the capital stock in Brazilian currency, the equity interest of each partner/shareholder in the corporate capital. The capital stock may be paid-in in domestic currency, credits, or assets (in case of the S.A., if payments are in assets, such assets must be subject of an evaluation report prepared by an expert or an accounting firm).

(g) Quotas/Shares. Number of quotas (Limitada) or shares (S.A.) to be held by each partner/shareholder and how these quotas/shares will be paid in. Usually (but not mandatory), the quotas or shares have the par value of BRL 1.00. In the case of an S.A., it is possible to stipulate that the shares have no par value. The shares of an S.A. may either be ordinary or preferred shares, the preference of which choice is related to either 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. Pursuant to DREI's Normative Ruling No. 81, a Limitada may also issue preferred quotas, even with no voting rights, although this is a subject of ongoing academic debate, as mentioned above.

(h) Management. Appointment of the individuals who will act as (**i**) managers of the Limitada; or (**ii**) officers of the S.A.; and if applicable (**iii**) members of the board of directors (at least three).

(i) Dividends. Provisions on allocation of dividends and losses among the partners/shareholders.

4. Formation.

3.1. Limitada: A Limitada is formed by filing its Articles of Association with the Board of Commerce of the State where the company's headquarters will be based. After the Articles of Association are filed, the Limitada will be considered as operational. There is no need to publish the Articles of Association.

3.2. S.A.: A S.A. is formed by filing, with the Board of Commerce of the State where the company will have its headquarters, the Minutes of Shareholders Meeting approving the formation of the S.A. and its by-laws. After registration, the Minutes must be published in the Official State Gazette and another newspaper in the city where the company's headquarters are located. The S.A. also needs to open and register certain corporate books.

4. Registrations.

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

(a) Federal Taxpayer Registration (CNPJ/ME): - required for all companies. The registration with the Federal Revenue 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.

(b) Registration of the Ultimate Beneficial Owner: All entities holding equity interest in Brazil must inform their "ultimate beneficial owner" to the tax authorities. The "ultimate beneficial owner" is any individual who: (i) holds, directly or indirectly, more than 25% of the capital of the company or (ii) regardless of the equity interest, directly or indirectly, controls or has the power to elect the majority of the administrators of the company.

(c) State Registration (required only for companies involved, directly or indirectly, in the manufacture 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 manufacture or sale of goods.

(d) Municipal Taxpayer Registration (CCM - required for all companies). This registration is made after the registration with the Board of Commerce and Federal Revenue.

(e) 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.

(f) Ministry of Labor and Social Security registrations (required for all companies).

(g) Brazilian Central Bank (required for all companies with foreign partners/shareholders).

(h) SISCOMEX (Integrated System of Foreign Trade - required for companies operating in foreign trade in Brazil, performing imports or exports), for the obtaining of an import license called "Radar" – Registration System for Tracking the Activities of Foreign Intermediaries. The granting of a Radar license is subject to the confirmation of the existence, the substance, and the financial and operating capacities of the company. There are three different types of import license: (**i**) "Express", (**ii**) "Limited" and (**iii**) "Unlimited":

(i) Express Radar. The Express Radar is only applicable to (**i**) publicly held S.A.; (**ii**) financial institutions; (**iii**) companies solely or partially held by the government; and (**iv**) companies operating export transactions which aggregate amount in any deemed period of six consecutive months is lower than or equal to USD 50,000;

(ii) Limited Radar. Under the "Limited" type of Radar, the company may import only up to USD 150,000 per semester. Such kind of Radar is indicated for companies that will import or export lower volumes. 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" type allows unrestrained freedom to operate foreign trade, but a recurring analysis on the financial capacity of the importer will be performed by customs authorities – regularly based on the level of taxes collected in Brazil – in order to continuously confirm the unlimited permission to import.

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 we estimate that a company is fully operational within 45 days following the filing with the Board of Commerce. The time for conclusion provided above is an estimated only, which depends entirely on the internal procedures of the applicable governmental entities as well as specific requirements depending on the industry and/or market of the company.

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 companies 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 Deemed Profit Regime and the Real Profit Regime, as further detailed below.

(b) PIS and COFINS contributions are also generally due by all companies. In most cases, their regime varies according to the income tax regime chosen by the taxpayer. If the company opts for the Deemed Profit Regime, as defined below, it will be subject to the PIS/COFINS cumulative regime, under which they are calculated in a simplified manner, with joint lower rates (3.65%), but without offsetting credits. If the company opts for the Real Profit regime, as defined below, it may be subject to the PIS/COFINS non-cumulative regime, under which they are calculated with a joint higher rate (9.25%), but with the possibility of offsetting certain credits. PIS/COFINS are also due upon importation of goods at a combined rate of 11.75% and upon importation of services at a combined rate of 9.25%. Credits may be booked depending on the regime the importer is subject to.

(c) The Import Duty is collected upon customs clearance of goods imported into Brazil. The taxable base is the CIF value of the goods. The rates are usually defined in a schedule based on the Harmonized System and ordinarily vary from 0% to 35% (goods considered to be “essential” are subject to lower rates while superfluous goods are taxed at higher rates). The amount paid upon customs clearance is not recoverable by the importer in the form of a credit and consequently becomes part of the cost of the imported product. Brazilian importation rules follow WTO standards, including in what respects valuation of goods.

(d) The IPI is an excise tax charged on a value-added basis and is imposed on the importation of goods, on their subsequent sale and on the sale of products arising from industrial processes. The taxable basis is the CIF value of the goods and the Import Duty in case of importation, or the value of the transaction on subsequent sales. Rates are also provided for by a schedule based on the Harmonized System,

ranging from 0% to 45% (as to the Import Duty, it follows the "essentiality" principle).

(e) The ICMS is a State tax charged on a value-added basis upon importation and sale of goods. On transactions taking place within the boundaries of any given State (importation and intrastate transactions), the tax is entirely due to such State. Sales across State lines impose the split of the tax between the State of origin and the State of destination. The general mechanism for this split is the determination of an interstate rate (4%, 7% or 12%) that is lower than the regular rate for intrastate transactions (usually 18%), allowing the destination State to collect the difference on the subsequent sales or the balance derived from the difference between the interstate and the intrastate rates when the acquirer is the end-user of the product (i.e., there is no subsequent transaction with the good)[7].

(f) The ISS (Municipal Tax on Service) is due upon the importation and the rendering of services, and its rates vary from 2% to 5%.

(g) Payments abroad are usually subject to a 15% withholding income tax, or 25% if to tax havens or if related to non-technical services.[8] Other taxes may be levied depending on the nature of the remittance. Dividends are tax free in Brazil, irrespective of the domicile of the beneficiary.

(h) The most relevant labor-related taxes are Social Security Contribution of 20% on payroll and Employment Security Fund – FGTS of 8%, also 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. They may not opt for the Deemed Profit Regime (a simplified system of taxation based on a statutory percentage of gross revenues).

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 arising from foreign sources (income

[7] Many products or transactions are subject to what is called the ICMS Substitution Regime (ICMS-ST), under which one participant in the production and consumption chain (usually the manufacturer or importer) anticipates the payment of the tax due across the entire chain, based on certain statutory presumed profit margins. After the entity appointed by the law as the "substitute taxpayer" makes payment of the tax, all subsequent transactions within the State boundaries are exempt from it. In the event of subsequent interstate transactions, the ICMS must be paid again by the seller and the amounts previously paid by the substitute taxpayer and ultimately collected from the seller become a credit to the seller.

[8] The definition of "technical services" is very broad, encompassing consultancy services, managerial assistance, or any other provision of service in which technical knowledge in general are applied. In practice, since all services are in certain level "technical", the 25% rate is not applied.

from foreign trade or services excluded); (**iii**) that enjoy tax benefits (exemption or reduction of income tax); (**iv**) that had made payments under the estimated system during the tax year.

(b) Deemed Profit Regime. Under this regime, the calculation of taxes is simplified. First, the company must determine its basis, which it does by applying a statutory percentage to its gross revenues (32% for services, including the assignment of rights, and 8% for the sales of goods). The resulting amount is the basis, to which the tax rate will apply.

The rates are the same as in the Real Profits Regime, that is: (**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-month deposits in the currency of the corresponding agreement[9] 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[10].

In the first three cases above, the maximum interest rate is increased by a 3.5% spread.

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 consists of 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 net worth of the Brazilian entity (or twice the overall net worth of the entity if lender does not hold any participation). In any case, the sum of all loans with related parties abroad must not exceed twice the value of the participation of foreign shareholders in the net worth of the Brazilian entity.

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[9] At the moment, Libor rates are only available for deposits in US Dollars, Euros, Pounds Sterling, Swiss Francs and Japanese Yen.

[10] This alternative is not in effect because the Treasury Ministry has not stipulated an interest rate in this case. Thus, controlled foreign loans concluded in Brazilian Reais with floating rate will be tested against the Libor rate for 6 months.

Thus, besides observing transfer pricing rules, the Brazilian companies shall pay attention 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 to1, in case 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). In this sense, 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 (Tax on Financial Transactions) 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).

Fall 21

INTERNATIONAL LAWYERS NETWORK

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ESTABLISHING A BUSINESS ENTITY IN CANADA

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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 1st, 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". This has proven to be 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 have adopted Business Corporations Acts, which largely mirror the CBCA and replace the former letters patent systems.

Generally speaking, incorporation under the CBCA is the most appropriate option if the corporation will carry on business in more than one Canadian province or territory. Alternatively, provincial or territorial incorporation would be better if 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.

There is, however, a potential disadvantage to incorporating under the CBCA: all such entities which are not publicly traded are required to maintain "a register of individuals with significant control over the corporation" (an "ISC"). This is defined as any individual who, as registered holder or beneficial owner, controls any number of shares (i) carrying 25% or more of the voting rights attached to all of the corporation's outstanding voting shares or (ii) equal to 25% or more of all of the corporation's outstanding shares measured by fair market

value. Two or more individuals can each be considered an ISC if they have joint ownership or control of 25% or more of the shares in votes or value. The CBCA corporation must maintain a register containing each ISC's name, date of birth and address, jurisdiction of residence for tax purposes, the day they became or ceased to be an ISC and a description of why they qualify as an ISC. This information must be updated at least once a year and may be maintained at the corporation's registered office or at any other place in Canada designated by the corporation's directors (for example, the law firm where its minute books are maintained). The information is accessible to shareholders and creditors of the corporation or their personal representatives upon request during the corporation's usual business hours, and they may obtain an extract from the register upon payment of a reasonable fee. The information may not be used by any person except in connection with (i) an effort to influence the voting of shareholders of the corporation (for example, a proxy solicitation); (ii) an offer to acquire securities of the corporation; or (iii) any other matter relating to the affairs of the corporation. Failure by the corporation, as well as its directors and officers, to establish or maintain the register without reasonable cause, the recording or provision by a director or officer of false information, and the failure by a shareholder to reply accurately and completely to a corporation's request for information, are all punishable by fines and a maximum of 6 months' imprisonment. Similar requirements are at various legislative stages in each province and territory, so this requirement will eventually become universal, across Canada, regardless of the jurisdiction of incorporation.

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, although tax treaties may limit the ability to take advantage of this favorable taxation. The Canadian version, however, does 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 and are 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 limited partners' liability 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, limited partners must remain passive investors rather than active participants 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 later need to change its name after having built up its 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; (iv) the shareholders' ratification of the by-laws; and (v) 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).

The majority of Canadian jurisdictions, including Ontario (as of July 2021) and Québec, do not have residency requirements for directors of a corporation. This is beneficial to foreign companies and investors that wish to carry on business in one of these jurisdictions. However, for companies incorporated federally under the CBCA or in Manitoba, Newfoundland and Labrador, or Saskatchewan, there is still a requirement that a certain percentage of the corporation's directors be Canadian residents.

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 usually do not 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 ENTITIES

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, it usually involves 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 located 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 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 regulation. Securities regulators from each province and territory have teamed up to form the Canadian Securities Administrators ("CSA"). 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 forms of securities, excluding only non-convertible debt securities. Thus, warrants, options and convertible debentures are covered by the securities rules in addition to 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. Individual accredited investors, except those who qualify as permitted clients (as defined in NI 31-103), must complete, and sign a risk acknowledgement form, indicating 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 situate, 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 frequently the case 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. 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).

As of December 2, 2021, employers in Ontario are prohibited from binding any employee to a non-compete agreement, unless the employee in question is (a) an executive, meaning that they hold a designated executive position, or (b) a seller of part or all of a business who becomes an employee of the buyer immediately following the sale. As well, employers with more than 25 employees, are required to have a written 'disconnecting from work' policy in place. Disconnecting from work means "not engaging in work-related communications, including emails, telephone calls, video calls or the sending or reviewing of other messages, so as to be free from the performance of work."

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 three provinces: Alberta's *Personal Information Protection Act* (PIPA AB); British Columbia's *Personal Information Protection Act* (PIPA BC); and Québec's *Act Respecting the Protection of Personal Information in the Private Sector* (Québec's Privacy Act). Québec's Privacy Act was very recently overhauled by the adoption of the *Act to modernize legislative provisions relating to the protection of personal information* (Québec), also known as Bill 64, which implements a major reform over the next 3 years, at the end of which the Québec rules will very closely resemble those of the European Union's *General Data Protection Regulation* (GDPR).

Notably, PIPEDA also applies to the inter-provincial and international collection, use and disclosure of PI. PIPA AB, PIPA BC and the Québec Privacy Act apply to the privacy and data protection practices of organizations within Alberta, BC, and Québec, 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

Canada's Anti-spam Legislation (CASL) requires 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).

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 transactions 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 across 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.

These rules apply to contests which are open to Québec entrants only, or to both Québec and non-Québec entrants resident in Canada. However, as of 2021, international contests which are open to both Québec and non-Canadian entrants are exempt from these rules, unless the international contest has strong ties to Québec (*e.g.*, it can only be entered from Québec either by attending an in-person event or depositing an entry at a store or other physical site in Québec). The Régie may also assert its jurisdiction if the contest sponsor's primary commercial interests are in Québec, regardless of international eligibility. Notwithstanding the qualification of the contest as provincial, national, or international, Québec's French language laws require contest rules, advertising and entry platforms to be translated into French for the Québec market.

Québec Charter of the French Language

The *Charter of the French Language* (Québec) makes French the official language in the Province of Québec, although other languages (such as English) may be used in certain circumstances and under certain conditions. These are expected to be significantly restricted if Bill 96 (*An Act respecting French, the official and common language of Québec*) is enacted as currently drafted. The comments below depict the current state of affairs since Bill 96 is not yet in force.

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 a registered trademark 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 registered 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^2 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, all signs and posters displaying trademarks in a language other than French must 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 (such as 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).

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 $415 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 (reduced for 2021 to CDN $93 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 (reduced for 2021 to CDN $93 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. Where the transaction is non-notifiable, however, 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 2021 has been reduced to CDN $415 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.

Any acquisition by a WTO investor (other than a state-owned enterprise) of a Canadian business having an enterprise value in excess of $1.043 billion may also be reviewed to determine the "net benefit to Canada." In the case of a direct acquisition of control of a Canadian business by a state-owned enterprise, the acquisition is

reviewable if the target business has total assets in Canada whose book value exceeds $415 million.

Similarly, the direct acquisition of control of a Canadian business by investors controlled in certain countries having a free trade agreement with Canada (*e.g.,* the United States and the European Union but excluding the United Kingdom post-Brexit) is reviewable where the 2021 enterprise value exceeds $1.565 billion.

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, 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.

Lastly, the government has the power 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 Canada-U.S.-Mexico Agreement (which replaced the North American Free Trade Agreement or NAFTA) 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, although 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; and (iv) expert witnesses or investigators.

Additional procedures apply to 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.

Canada-U.S Mexico Agreement ("CUSMA")

Under CUSMA, which replaced the North American Free Trade Agreement on July 1, 2020, 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 CUSMA provisions. CUSMA 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.

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

PAGBAM | SCHWENCKE

ESTABLISHING A BUSINESS ENTITY IN CHILE

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN CHILE

I. Types of Business Entities

1. Description of the types of entities available

In Chile, there are different types of entities available to establish a business. The most common entities for foreign investment are: (i) Limited Liability Partnership or Company (*Sociedad de Responsabilidad Limitada*, "SRL"); (ii) Corporation (*Sociedad Anonima*, "SA"); and (iii) Stock Company (*Sociedad por Acciones*, "SpA").

a) Sociedad de Responsabilidad Limitada

The SRL has a minimum of two partners and a maximum of fifty. There is no restriction on foreign partners. There cannot be less than two partners, as the partnership is automatically dissolved if there is only one partner. Each partner's liability is limited either to the amount they contributed to the capital, or an upper amount specified in the partnership deed. This company differs from the next two (SA's and SpA's) in its character as "persons corporation", where the identity of the partners and the relation between them is essential to the validity of the company, in such length that the names of the partners are included in the bylaws.

The deed must contain certain minimum requirements established by law in order to be valid, such as the company's name, domicile, corporate purpose, capital, etc. and any other relevant terms agreed to by the partners.

Capital and Partnership Rights. There are no minimum capital requirements for the incorporation or the operation of an SRL. The partners may pay the stock capital in cash, assets, or by their work or activity. There are no restrictions regarding the distribution of profits, so the partner may freely agree on any percentage in the bylaws. If the bylaws do not regulate the distribution of the profits, the law mandates to distribute them in the same proportion of their contribution to the stock capital.

Given that the transfer of partnership rights requires the amendment of the SRL´s bylaws, the partner willing to sell its rights needs to obtain the prior consent of the others.

Management. The partners have the freedom to choose how to manage the SRL. Usually, the partners will manage the partnership by their own, or through one or more representatives, elected by unanimity, of which at least one must be domiciled in Chile. The partners may also entrust the management to a board of directors or a single director, both to be chosen by unanimous agreement. An SRL is not subject to the control of a regulatory authority and there is no obligation to publish or file accounts.

b) Sociedad Anónima

An SA is a company formed by a common fund provided by two or more shareholders who are responsible only for their respective capital contributions. There cannot be less than two shareholders. In opposition to what was mentioned regarding SRL´s being persons corporations, SA's (and SpA´s) are "capital corporations", being the contribution of capital the main interest in this type of entities.

The deed must contain certain minimum requirements established by law in order to be valid, such as the company's name, domicile, corporate purpose, capital, etc. and any other relevant terms agreed to by the shareholders. It must also contain the by-laws of the company.

Capital and Shares. In general, there are no minimum capital requirements for the

incorporation or operation of an SA. Nonetheless, there are some exceptions regarding determined types of businesses, where a special law requires a minimum capital for its constitution and ongoing operation, such as banks and insurance companies. The capital of a SA may be paid with cash or assets. According to the law, the initial capital must be fully subscribed and paid within three years counted as of the incorporation of the corporation. If the capital is not subscribed within this term, it will be automatically reduced to the amount effectively subscribed and paid.

An SA may be publicly traded or closely held. If it is publicly traded, the shares are publicly traded at the stock market, either as a legal requirement or voluntarily. In this case, the corporation is subject to the supervision by the Commission for the Financial Market (*Comisión para el Mercado Financiero*, "CMF") and, therefore, the shares must be registered in the Securities Register of this regulatory body. Shares of closely held SAs are privately traded.

Shareholders of a SA may freely transfer their shares without the consent of the other shareholders, and without amending the corporation's bylaws.

Distribution of profits in closed SA's is ruled by the bylaws. If there are no provisions on point, distribution is ruled by the general rules affecting open corporations, under which at least 30 percent of net profits must be distributed in cash, unless otherwise agreed by all shareholders. In case of accumulated losses, the profits of the period must be used first to cover said losses.

Management. SAs are managed by a board of directors of at least three members, who are essentially revocable. The chairman and CFO of the company are elected by the same directors. The board of directors is vested with ample managing powers and can represent the SA before third parties.

c) Sociedad por Acciones

An SpA is fairly similar to a SA, but simpler. Besides certain minimum provisions set forth in the law, the shareholders are free to agree upon any rules in their bylaws. It seeks to combine the flexibility in management of an SRL, with the structure of rights and obligations of a SA.

Unlike the prior companies, SpA's may have one single shareholder for all the duration of the entity. They are therefore preferred by Venture Capital Companies and other companies with an intention to incorporate partners in the future.

Capital and Shares. There are no minimum capital requirements for the incorporation or the operation of a SpA. The shareholders may pay the stock capital in cash, assets, or the contribution of personal work (which is not allowed under an SA structure). The initial capital and capital increases must be fully subscribed and paid within the term fixed by the shareholders, or a maximum of five years counted from the incorporation or the capital increase date if such term is not set forth in the bylaws.

The bylaws can establish that the SpA may issue different kinds of shares, such as non-voting preferred shares, limited-voting shares, or with multiple votes.

In general, shareholders of a SpA may freely transfer their shares without the consent of the other shareholders and without amending the bylaws.

If an SpA reaches 500 (five hundred) or more shareholders or, at least, 10% of the nominal capital belonging to a minimum of 100 (one hundred) shareholders, during more than 90

(ninety) days, the entity will be transformed into a SA *ipso facto* and will be submitted to the SA regulations over their bylaws. The next shareholders meeting held will have to make the corresponding adaptations and chose the members of the board.

Management. The SpA's obligations are basically two: appoint a general manager and to hold ordinary shareholder meetings. Shareholders are free to decide on the management structure, and they can designate a single manager or a board of directors.

2. Matters to be considered when choosing a business entity type

There are several advantages and disadvantages related to each type of entity. When choosing, it is vital to consider the following elements:

a) Sociedad de Responsabilidad Limitada

- It has a minimum of two partners and a maximum of fifty.
- All partners may be foreigners.
- The responsibility of the partners is limited to its capital contribution.
- Its management is simpler compared to an SA.
- The partners have the flexibility to agree on the terms of the bylaws. There are no limitations regarding the capital, its payment, and the distribution of profits.
- Partners need unanimity to adopt all types of decisions.
- Partners that want a relationship of trust, fewer formalities, and simplified management, prefer this entity.

b) Sociedad Anónima

- There is no limitation for the transfer of the shares.
- Foreign entities can hold 100% of an SA's shares.
- Generally, there are no minimum capital requirements.
- The creditors have rights over the assets of the corporation, not over the property of the shareholders.
- They have a complex management organization (board of directors + shareholders meetings).
- They can operate in the stock market.
- If they are publicly traded, they have reporting duties towards the CMF.
- Businesses requiring large amounts of capital prefer the S.A. corporate structure.

c) Sociedad por Acciones

- It may be constituted by one or more shareholders, without limitations.
- There is almost complete flexibility in agreeing upon the bylaws of the company.
- Foreign entities can hold 100% of an SpA's shares.
- It is flexible in its administration.
- Shares trading is simpler.
- The shareholders can determine the number and types of shares that constitutes the capital.
- The shareholder's responsibility is limited.

- Enterprises seeking to attract venture capital prefer the SpA corporate structure.

II. Steps and Timing to Establish

1. Brief overview of steps to incorporate/constitute each entity

a) *Sociedad de Responsabilidad Limitada*

The constitution of an SRL requires a public deed granted before a notary public by at least two partners. Within the next sixty days, the partners must register an excerpt of the document in the Register of Commerce corresponding to its domicile and publish it in the Official Gazette.

Any amendment to the bylaws requires the agreement of all the partners, recorded in a public deed. An excerpt of it must be recorded in the Register of Commerce and published in the Official Gazette within 60 days.

b) *Sociedad Anonima*

The establishment of a SA requires the same process as the one described for the SRL. In the case of an amendment to the bylaws, an extraordinary meeting of the shareholders, in the presence of a notary public, is required. Besides certain particular matters which require the approval of two-thirds of the shareholders with voting rights (transformation into a different type of company, reductions of capital, sale of more than 50% of the assets, et all), ordinary amendments require majority of shareholders to be approved. The shareholders must record a brief of the meeting into a public deed, and, within the next sixty days, an excerpt containing the amendment must be filed at the Register of Commerce and published in the Official Gazette.

c) *Sociedad por Acciones*

The incorporation of an SRL requires a public deed, or a private document signed by all the shareholders, in which case a public notary must verify and legalize it. Within a month as of the date of the incorporation document, its excerpt must be registered at the Register of Commerce and published in the Official Gazette.

Any amendment to the SRL's bylaws requires the approval of the shareholders in a meeting as described for SA's. Nevertheless, this is not necessary if all shareholders appear granting such amendment in a public deed or a private instrument before a public notary. Within a month as of the date of the amendment document, its excerpt must be registered at the Register of Commerce and published in the Official Gazette.

2. Other Formalities

Tax Number: After the legal constitution is completed, all entities must obtain a Tax Number (RUT) before the Internal Revenue Service (*Servicio de Impuestos Internos*, "SII"). Foreign investors that wish to hold a share in a local entity must also obtain a Tax Number and appoint a legal representative on their behalf with domicile or residence in Chile. For these effects, the SII will require (i) the appointment of a local representative, with domicile in Chile with sufficient authorities to represent the foreign investor; and (ii) evidence of existence of the foreign investor (in case of an individual, a legalized copy of its passport; and, in the case of a legal entity, a copy of its bylaws and a certificate of good standing, duly legalized and translated into Spanish).

There are two alternatives to obtain the Tax Number. The standard procedure and the simplified procedure. The standard procedure may be undertaken by the foreign investor or

through a legal representative domiciled or with residence in Chile. If the foreign investor undertakes the procedure, he/she will have fill out the Form F-4415 (Registration of RUT and Sworn Declaration of Start of Activities). If the legal representative undertakes it, he/she will have to be given a power of attorney granted before a public notary in Chile, or in a foreign country, and legalize it per the Apostille Convention of The Hague or by the Chilean Consulate of the corresponding jurisdiction. The simplified procedure is carried out directly by authorized banks and stockbrokers who can obtain the Tax Number for customers who invest in Chile.

Starting Activities. If the investment implies the exercise of an economic activity in Chile, the investor will have to "initiate activities" before the SII. This procedure requires a sworn statement in which the taxpayer informs the intention to initiate economic activities in the country, and that they may be taxable. It can be filed electronically on the web page of the SII.

Municipal Licenses and Permits. According to the nature of the economic activity involved, certain permits and municipal licenses may be required. Municipal licenses authorize the entity to undertake a specific economic activity within the municipal territory.

III. Governance, Regulation and Ongoing Maintenance

1. Summary of regulation of each type and ongoing maintenance, reporting requirements

The partners of an SRL may mandate the administration to one or more partners or a third party, or parties, appointed in the company's bylaws. If the partners do not delegate a decision to the administrator, it must be taken unanimously by the partners.

Administration of an SA is entrusted to a Board of Directors. The shareholders' meeting elects the members of the Board by the majority of the shareholders. The bylaws of the SA will determine an invariable number of directors that will integrate the Board and the term of their mandate, that may not exceed three years. The shareholders will meet in ordinary meetings once a year following the bylaws, and extraordinarily if required.

In case of a SpA, the shareholders may agree to manage the company through one or more administrators (like in the case of a SRL), or a board (like in the case of a SA). The bylaws must consider this agreement.

2. Requirements for local shareholders/directors

In Chile, there are no requirements for companies to have a local shareholder.

Though the directors of SA's and SpA's may be fully integrated by foreigners, these companies, together with SRL´s must have at least one local representative, authorized to respond before and be notified by local authorities.

It should be noted that directors of SA's and SpA's hold a fiduciary duty toward the company, which contemplates certain attributions such as full access to all business of the company, but also duties of care and confidentiality. Directors are joint and severally responsible before the company and its shareholders for any damages caused to them due to the infringement of said duties.

3. Minority shareholders' rights and protection

Chilean corporate law establishes a withdrawal right in favor of the minority shareholders when the controller acquires more than 95% of the shares of a publicly traded SA. The minority shareholder must exercise this right within 30

days counted from the date in which the shareholder reached more than de 95% of the shares.

IV. Foreign Investment, Residency and Material Visa Restrictions

1. Any significant barriers to entry for an offshore party

In general, there are no restrictions for the development of economic activities. More specifically, as the economic activity is not limited to the State or a Chilean natural person o legal entity, there are no limitations for offshore parties. Save as mentioned below, all the economic activities are open to the private sector, and foreign parties may develop most of them.

There are some activities that subject to certain restrictions. for example:

- **Border areas**: Some territories located in border regions of the country cannot be acquired by natural persons from a neighboring country or by legal entities with their headquarters in a neighboring country unless they count with the authorization of the President of the Republic.
- **Aquaculture and fishing**: There are several activities regarding aquaculture and fishing that are restricted only for national natural persons or entities.
- **Hydrocarbons, lithium, and deposits in Chilean waters**: Mining concessions located in areas classified as vital for national security cannot be awarded to foreigners.
- **Domestic shipping**: Only Chilean boats are permitted to transport passengers and freight along the coast, rivers, or lakes. However, foreign merchant vessels may undertake these activities in the case of cargo volumes exceeding 900 tons.
- **Insurances and Reinsurances**: These businesses can only be developed in Chile by national corporations.

2. Foreign investment

Chapter XIV of the Central Bank's Compendium of Foreign Exchange Regulations regulates the entry of foreign capital into Chile. All operations involving loans, deposits, investments, or capital contributions for over US$10,000.-, or its equivalent in other currencies, are subject to this mechanism. Any of these operations must be done through a formal foreign exchange market, such as banks and currency exchange offices authorized by the Central Bank. This administrative system operates through commercial banks or entities, which reports the entry of the capital directly to the Central Bank. Any other operation which involves the entry of foreign currency must be reported directly to the Central Bank by the investor or by the recipient of the investment.

3. Any special business or investment visa issues

In Chile, a foreign person needs a visa if he/she is willing to stay and develop economic activity. The main types of visa are issued by Chile are tourist visa; visa subject to work contract; and temporary residence visa. The temporary residence visa is relevant for business and investment purposes. It is granted to foreigners who have family ties in Chile, interests in the country, or whose residence is considered useful or advantageous and allows the holder to reside temporarily in Chile, to work, study or undertake commercial activities.

There are different types of temporary residence visa, according to the motivation for which it is requested. There is a special visa for foreign investors, entrepreneurs, or traders

who intend to remain in the country for more than 90 days for business purposes. These people may apply for a Businessperson and Investor Temporary Residence Visa. The application should accompany the information regarding the investment project and the capital involved.

These visas may be processed at the Chilean Consulate in the country of origin or Chile. Nonetheless, we recommend processing it outside the country because most of the times it is faster. They are awarded for a maximum of one year and can be renewed. After that, if the foreign wants to remain in the country, he/she must apply for permanent residence.

Notwithstanding the above, please note that a new Immigration and Foreigners Law was passed on April 11th, 2021. However, said Law will come into force only after its regulation is also passed by the Chilean legislative authority, which has not yet happened.

4. **Any restrictions on remitting funds out of the jurisdictions (withholdings, etc.)**

Remittances of profits abroad are subject to a 35% tax, whether in countries with or without an Agreement to Avoid Double Taxation with Chile. If the remittance is subject to Additional Tax, the company paying the tax may charge, as a credit, the First Category Tax paid, against the Additional Tax. The amount of the credit will be equivalent to 100% or 65%, depending on its nature, and the country of residence of the receptor. Chilean tax regime has been subject to successive reforms and numerous administrative regulations over the law are still pending to be issued. Therefore, tax advise must be sought on a case-to-case basis.

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INTERNATIONAL LAWYERS NETWORK

LLINKS LAW OFFICES

ESTABLISHING A BUSINESS ENTITY IN CHINA

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN CHINA

In general, foreign funds are not freely movable into China. There is a long history of exercising comprehensive control over foreign investment since China opened its door in the early 1980s. As the economy continues to grow, China has been gradually loosening the substantive and procedural requirements on foreign investments and carefully testing the water for national treatment for foreign investors in the past decade. On January 1, 2020, the Foreign Investment Law came into force, which marked a new height of the Chinese government's supportive attitude towards foreign investment. It abolished the pre-approval scheme for foreign investments in existence for over forty years and officially effected a regime of "national treatment plus negative list" for foreign investment.

1 Foreign Investment Supervisory Scheme

The so-called "national treatment plus negative list" scheme is designed to offer national treatment for most foreign investments; and foreign investors enjoy the same treatment as set forth for all other businesses with only domestic investors, except for those falling within a "negative list" as published from time to time by the relevant authorities. The currently effective "negative list" refers to the Special Administrative Measures (Negative List) for Foreign Investment Admission (2020 Edition), promulgated jointly by the National Development and Reform Commission and the Ministry of Commerce of the PRC[11].

[11] Published on June 23, 2020, and effective on July 23, 2020.

The establishment of business in China by foreign investors is supervised by multiple regulatory bodies. The State Administration for Market Regulation and its local counterparts (collectively, the "**AMR**") are the business registration authorities responsible for administering and registering all kinds of businesses in China; while the establishment of a foreign-invested business is also subject to the special regulation by the Ministry of Commerce or its local counterparts (collectively, "**MOFCOM**") on the admission of foreign investment, and the State Administration of Foreign Exchange and its local counterparts (collectively, "**SAFE**") on foreign exchange control. Additionally, if a business involves investment in real estate assets or infrastructure in China, filling with or approval by the National Development and Reform Commission or its local counterparts (collectively, the "**NDRC**") is required.

2 Legal Structure Choices

Before learning more about the procedural requirements, the first step that a foreign investor normally faces is to choose a legal structure that works best for its proposed business. Foreign investors generally have the option of three types of business vehicles: the resident representative office, the company, and the partnership.

1) Resident Representative Office of a Foreign Enterprise ("**RO**")

Some foreign investors may choose to register an RO as their first presence in China. An RO cannot directly operate business and is mainly set up for liaison and other non-business activities. It has no legal personality, and its liabilities

are borne by its foreign parent enterprise. As such, it fits those foreign investors who have not decided to commit to a long-term establishment in China.

a) *Business activities*

ROs are not permitted to directly engage in business activities; but are only permitted to engage in: (i) market investigation, displays, and promotion activities in connection with the products or services of their foreign parent enterprises; and (ii) liaison activities in connection with products sales, services provision, domestic procurement, and domestic investment by their foreign parent enterprises.

b) *Representatives*

The foreign parent enterprise of an RO shall appoint one chief representative, and one to three representatives to the RO.

c) *Capital*

There is no requirement to make any capital contribution when establishing an RO. The working capital that an RO needs for carrying out the permitted activities are provided by its foreign parent enterprise.

2) Company

A foreign-invested company may be established in the form of either a limited liability company or a company limited by shares. A company has a legal personality and possesses independent corporate assets. As one of the most popular structure choices, the company attracts investors mainly because it provides investors limited liability protection and the investors are only liable for the amount of their committed investment to the company.

a) *Limited Liability Company ("**LLC**")*

- Limited liability

  The shareholders' liability is limited to the aggregate subscription price of their subscribed capital.

- Capital

  - The registered capital of an LLC is the total subscribed capital of all the shareholders, which shall be registered with the AMR upon formation. Any subsequent increase or reduction of the registered capital subscribed by a shareholder requires change of the LLC's registration information with the AMR. Although in most cases, the registered capital of an LLC is subscribed by an investor at its face value, it is possible that an investor subscribes for registered capital at a premium.

  - The shareholders do not have to contribute their subscribed registered capital in full at the time of the subscription. Except as otherwise required by law for some special cases, the shareholders may schedule their contribution of subscribed registered capital as agreed among

themselves.

- In addition to the registered capital, a foreign-invested LLC shall also have a "total investment amount" that represents the estimated total amount of funds needed for the operation of the company, including capital injection by the shareholders and funds generated through other channels. The maximum total investment amount of a foreign-invested LLC allowed is based on the amount of its registered capital, as the law requires that the two amounts shall be kept in certain proportion. Foreign-invested LLC may borrow loans to make up the difference between its registered capital and total investment amount, including foreign debts.

– Number of shareholders

The maximum number of shareholders that an LLC may accept is fifty.

– Governance

- Since the Foreign Investment Law took effect on January 1, 2020, a newly formed foreign-invested LLC shall have its shareholders' meeting as the highest organ of authority [12]. Except as otherwise provided by law, the proceedings and voting procedures of the shareholders' meeting shall be stipulated in the articles of association of the LLC.
- An LLC shall have a board of directors which runs the business and operation of the LLC and is responsible to the shareholders' meeting. Alternatively, the LLC may also choose to have only one executive director.
- An LLC shall have a board of supervisors, which reports to the shareholders' meeting, and is responsible for monitoring the operational and financial affairs of the LLC as carried out by the board of directors[13]. At least one thirds of the members of the board of supervisors shall be employee representatives.
  Alternatively, the LLC may also choose to have only one or two supervisors.
- An LLC shall have a legal

[12] Prior to the enactment of the Foreign Investment Law, there are other types of foreign-invested entities, some of which was required to have the board of directors as their highest organs of authority.

[13] When referring to the board of directors, the executive director is also included, as the case may be.

representative. The legal representative is deemed as the representative of the LLC in civil activities unless otherwise communicated to third parties. However, the law does not vest executive power in the legal representative. As such, the legal representative has to carry out activities on behalf the company within the authorized scope. The legal representative candidate is limited to either the chairman of the board of directors, the executive director, or the manager of the LLC.

- An LLC shall also have at least one manager that carries out the day-to-day operation of the company. The manager is appointed or removed by the board of directors and reports thereto.

b) *Company Limited by Shares ("**CLS**")*

A CLS in China is similar to a corporation in many other jurisdictions. Unlike an LLC where the ownership of the shareholders is represented by subscribed capital, the shareholders of a CLS subscribe for shares. Investors tend to choose the CLS where the company is in a larger scale. In general, it is more burdensome to operate a CLS than an LLC, as the law sets higher requirements for CLSs with respect to corporate governance, standardized operation, and many other aspects.

- Limited liability

  The shareholders' liability is limited to the aggregate subscription price of their subscribed shares.

- Capital

  Like an LLC, a CLS will also have a registered capital and a total investment amount although the requirements differ in detail.

- Governance

  - The shareholders' general meeting is the highest organ of authority of a CLS. The articles of association of a CLS may provide for the proceedings and voting procedures of the shareholders' general meeting except as otherwise mandated by law.
  - Like an LLC, a CLS shall also have a board of directors, a board of supervisors, a legal representative, and one or more managers that exercise powers and undertake obligations similar to those described in subsection a).
  - The law provides for higher requirements regarding the day-to-day operation and management of a CLS. For example, a CLS must have a board of five to nineteen directors and a board of at least three supervisors – an executive director or one or

two supervisors is not allowed. The law also provides for mandatory procedural requirements for the proceedings of the shareholders' general meetings and the meetings of the board of directors that shall be followed by all CLSs.

3) Partnership

Partnerships in China do not differ much from partnerships in many other jurisdictions. A partnership may be established in the form of either a general partnership or a limited partnership. It does not have a legal personality and bears unlimited liabilities to its creditors. The partnership is nevertheless a popular structure choice as it offers more flexibility to the partners in the governance and operation thereof.

a) *General Partnership*

- Unlimited liability

  A general partnership shall have at least two partners, each bearing joint and several unlimited liability to the creditors of the general partnership.

- Capital commitment and contribution

  - Upon formation, the partnership shall register the aggregate capital commitment of all partners, as well as the capital commitment of each partner. Any subsequent increase or reduction of the capital commitment of a partner requires an amendment of the partnership's registration information.
  - Except as otherwise required by law, the partners may schedule their capital contributions in the partnership agreement.

- Governance

  A general partnership is governed by the partners' meeting. The specifics of the partners' meeting may be stipulated in the partnership agreement, including the proceedings, the matters requiring approval of the partners, and the required votes, etc.

b) *Limited Partnership*

- Limited or unlimited liability

  A limited partnership shall have at least one general partner and one limited partner. The liability of a limited partner to the creditors of the limited partnership is limited to the amount of its capital commitment, while the liability of the general partner is unlimited.

- Capital commitment and contribution; governance

  The capital commitment and contribution by the partners, and the governance of a limited partnership are similar to those

of a general partnership, as introduced in subsection a) above.

- Carryout of partnership affairs

  By and large, the affairs of a limited partnership shall be carried out only by the general partner. If a limited partner carries out the affairs of the limited partnership or externally represent the limited partnership, it may lose the limited liability protection and be exposed to unlimited liability together with the general partner.

3 Formation

1) Formation of an RO

When establishing an RO, the applicant shall apply to the relevant AMR where the RO will be domiciled, and submit application documents such as a certificate certifying the legal operation of the foreign parent enterprise for at least two years, a bank reference letter, the constitutional documents of the foreign parent enterprise, the identity documents of the chief representative and the representative(s), a certificate of right to use premises, etc.

After the application is approved, a certificate of registration will be issued to the RO evidencing its formal establishment.

2) Formation of a Company or a Partnership

The formation of a foreign-invested company or partnership (each a foreign-invested entity, "**FIE**") in China in general requires more complicated procedures and longer time frame than usually seen overseas. A majority of foreign investors choose to engage a lawyer to assist them through the process. Sometimes, foreign investors may also hire a registration agent to assist.

As mentioned in the introductory paragraph, China currently administers a "national treatment plus negative list" regime on admission of foreign investment, whereby the business activities that a foreign investor intends to engage in China are divided into three categories: the "prohibited categories," the "restricted categories," and the "permitted categories." The negative list lists all "prohibited categories" and "restricted categories," and is updated by the relevant authorities from time to time. All other businesses which are not listed in the negative list are "permitted." A foreign investor will not be allowed to engage in a business that is in the prohibited categories; but may be allowed to engage in a business that is in the restricted categories, provided that it meets the restrictive requirements set forth in the negative list (for example, the foreign investor can only hold minority percentage of equity in the business entity).

The assessment of whether a proposed business is prohibited, restricted, or permitted; and if restricted, what requirements apply, can be complicated. It is highly recommended that the foreign investor consult a legal counsel in advance in this regard. The introduction below focuses on the establishment of an FIE that does not fall within the negative list. Also, the formation of a new FIE by a foreign investor and the investment in an existing FIE by a foreign investor require similar procedures. The below discussion does not specifically distinguish between the two.

a) *Registration with the AMR*

Although the registration of an enterprise is under the unified administration of the State Administration for Market Regulation, the foreign investor shall keep in mind that the relevant AMR where the FIE will be domiciled may have its own nuanced requirements regarding the application documents and procedures. In general, the application package shall include an application form, the AOA signed by all the shareholders, the appointment documents for all required positions, and identity documents of the legal representative, the directors, the supervisors and the manager, and the incorporation certificate (or its equivalent) or identity document of each investor, etc.. To date, almost all local AMRs administer the application process online through its online system ("**AMR System**"). The application documents may in principle be submitted online in scanned form although some local AMRs may also require original copies or photocopies to be submitted onsite.

After the registration application is approved, the AMR will issue a business license to the FIE which evidences its due formation.

b) *Reporting to MOFCOM*

As mentioned in the recital, MOFCOM is responsible for regulating the admission of foreign investment. While a foreign investor applies to the relevant AMR for business registration, it shall submit a report to MOFCOM regarding the proposed foreign investment. To ease the burden on foreign investors, instead of a separate reporting procedure, now the reporting to MOFCOM may be completed through the AMR System, where MOFCOM will collect and review information regarding the proposed foreign investment.

For the purpose of reporting to MOFCOM, the basic information of the FIE (such as its name, registered office, type, industry involved, business scope, registered capital, senior managers, etc.), as well as the basic information of its investors (such as place of establishment, place of funds source, subscribed and paid-in capital, ultimate controller, etc.) shall be submitted through the report form on the AMR System. If the foreign investor is making the investment by acquiring interests from an existing shareholder of the enterprise, it will need to submit additional information regarding the proposed transaction and the parties to the transaction, etc. If the foreign investor is investing in a listed company, it will need to comply with eligibility requirements which may involve additional information being collected.

4 Operational Considerations

1) <u>Post-formation Registration</u>

After obtaining the business license, an FIE shall complete various post-registration procedures before formal operation, such as the foreign exchange registration with the relevant banks, the tax registration with the local counterpart of the State Taxation Administration, and the social security

registration with the social security authority, etc.

2) Approval by or Filing with the NDRC

Where the business of an FIE involves an "investment project" (typically referring to a fixed assets or infrastructure investment project), additional filing with or approval by the NDRC will be required before such investment project may be commenced. NDRC administers a two-level system where the types of investment projects listed in the Catalogue of Investment Projects Subject to Governmental Approval[14] ("**Approval Catalogue**") are subject to an approval process; and investment projects not listed in the Approval Catalogue are subject only to a less burdensome filing. It is worth noting that, although the Approval Catalogue applies to both domestic and foreign investment projects, it specifically prescribes that foreign investment projects involving "restricted categories" in the negative list are subject to the approval by the NDRC, even if not specifically listed in the Approval Catalogue.

For approval-required investment projects, a project application report shall be submitted, along with a variety of documents that support the analysis that the project complies with the requirements listed in the Approval Catalogue and/or the negative list, as the case may be. Typically, such requirements may include demonstration of not detrimental to national security, the ecological environment and public interest, etc. For filing-required investment projects, only general information regarding the project and the investors and basic documents will need to be submitted. For either kind of projects, the foreign investor should be mindful that the required documents may vary depending on where the foreign-invested project is located and which industry it involves. Confirmation in advance with the local NDRC on the specific requirements may help save time in going through the process.

3) Annual Reporting

a) *RO*

An RO shall submit an annual report to the relevant AMR during the period from March 1 to June 30 of each year. The annual report shall include information such as the legally existing status of the foreign parent enterprise, the activities carried out by the RO, the income and expenses of the RO as audited by an accounting firm, etc.

b) *FIE*

During the period from January 1 to June 30 of each year, an FIE shall submit its annual report through the National Enterprise Credit Information Publicity System of the AMR. The annual report shall include information of the FIE such as its basic information, its investors and ultimate controller, its operation status and assets and

[14] Refers to the Catalogue of Investment Projects Subject to Governmental Approval (2016 Edition), promulgated by the State Council on December 12, 2016.

liabilities, etc. This process is now commonly called the "joint reporting," as information submitted in the annual report will be shared among the AMR, MOFCOM and SAFE.

4) Foreign exchange

"Renminbi", the legal currency in China, is not a freely convertible currency; and foreign currencies are not allowed to be freely converted or used in China. Foreign exchange transactions, such as the payment or receipt of foreign exchange, are regulated by SAFE.

Compared with most entities owned by pure domestic investors, an FIE enjoys some relaxation with regard to foreign exchange [15], as it may accept investments from outside of China, and may settle foreign currency capital contributions made by its foreign investors into renminbi "at will" for its daily operation. The receipt and payment of foreign exchange during the ordinary transactions of an FIE may in general be handled without additional approval by SAFE, although the processing bank may require certain documents be submitted to support the authenticity and legality of the underlying transaction.

An FIE may also borrow foreign loans from its foreign parent or other channels to fund its operation. The specific rules are a little complicated; however, normally foreign loans are permitted within the difference between the registered capital and the total investment amount of the FIE, or a quota calculated based on its net assets.

The profits of an FIE, after payment of withholding tax (as discussed below) and certain statutory company reserve funds (if applicable), may be legally remitted out of China to its foreign investors.

5) Land

In China, all lands are owned by the public; and in this sense, there is no "private land" in China.

The ownership of the land is divided into two types: ownership by all people (in this case, the state owns such land on behalf of all people, and therefore the land normally is called "state-owned land"); and ownerships by collectives (such as all farms and villages in the area).

Most FIEs can start their business in China with a leased property such as an office. But for FIEs that wish to build facilities or buildings on the land which they have more control, they shall purchase land use rights from the local government which administrates land within its jurisdiction. The procedures required apply equally to foreign and domestic purchasers, which involves a relatively open and transparent public bidding process. Depending on the purpose of use of the land, the applicable term of use varies, such as fifty years for land zoned for industrial use and forty years for land zoned for commercial use.

[15] Enterprises with investments from domestic investors may be subject to higher scrutiny with regard to foreign exchange.

6) Tax

China has a comprehensive taxation system, which is modelled after or similar to some major western countries. Taxes related to a business entity are complicated. For FIEs, the taxes most closely relevant to their business in China are value-added tax ("**VAT**"), income tax and withholding tax.

a) *Value-added Tax*

In general, VAT is imposed widely on revenue generated from the sale of goods or intangible assets, as well as provision of processing, repair, maintenance, transportation, profession, and other services. Therefore, most FIEs will be collected the VAT during their daily business operation.

The VAT rate may vary depending on the underlying business activity. For example, it is 13% for trading of goods, 6% for services, 9% for transfer of land, etc. If an FIE pays the VAT to third parties, it may be able to enjoy relevant deduction for such VAT.

b) *Income Tax*

- Corporate Tax

China currently enforces a unified income tax treatment for all companies in China, with a tax rate of 25%. A "resident enterprise"[16] is subject to tax on its worldwide income.

It should be noted that, the law provides tax incentives to those resident enterprises that invest in high and new technology and certain other encouraged industries. It is recommended that FIEs assess their eligibility for available preferential tax treatments.

- Individual income Tax

Individual income tax applies to foreign nationals that are residing in China or have income deriving from China, depending on their working and residence status in China.

- Partnership

In principle, partnerships in China are tax pass-through entities and do not need to pay income tax at the partnership level. The partners are subject to income taxes on their distributive share of the business profits earned from the partnership.

Although a foreign-invested partnership is a "pass-through" entity and not directly subject to income tax, it needs to pay other

[16] A resident enterprise refers to an enterprise legally established in China, or an enterprise established according to the laws of a foreign jurisdiction but has an actual operating institution in China. Therefore, an FIE falls under the scope of a resident enterprise.

taxes related to its business, such as VAT, urban maintenance and construction tax and stamp duty, etc.

c) *Withholding Tax*

Withholding tax is imposed on all income generated in or derived from China by foreign investors, such as dividends, interest, royalties, rental income, or profits on transfer of assets, etc.

The currently applicable withholding tax rate for foreign investors is ten percent. The withholding tax rate is subject to adjustment under applicable tax treaties or arrangements. For example, the tax arrangement with Hong Kong provides for a five percent reduced withholding tax rate on dividends and a seven percent reduced withholding tax rate on loyalty incomes provided that certain requirements are met under such tax arrangement.

d) Other Taxes

There are other taxes that may apply to an FIE during its operation and activities, such as the customs duty, urban maintenance and construction tax, and stamp duty. It is recommended that an FIE consult a legal or tax advisor for a comprehensive tax assessment that might be applicable to its specific case.

7) Labor

a) *Hiring capacity*

Under Chinese labor laws, ROs are not eligible to hire employees directly. An RO shall engage a local authorized labor agency to hire employees, and the labor agency will dispatch such employees to the RO.

By contrast, a company, or partnership can directly hire employees.

b) *Labor contract*

All employers in China shall execute a written labor contract with each employee within one month from the date when the employee starts to work. Otherwise, the employer is required to pay double salary to the employee from the second month. If the employer fails to enter into a written labor contract with an employee for more than one year, it will be deemed that the two parties have entered into a permanent labor contract.

The employer is subject to different obligations to the employee under either a fixed-term labor contract or a permanent labor contract; and its obligations are more burdensome under the latter. Subject to local exceptions, in principle, when an employee and the employer have concluded two consecutive fixed-term labor contracts, the employer shall enter into a permanent labor contract with the employee upon renewal.

c) *Social security*

The employer shall contribute social security insurances and housing fund for employees on a monthly basis. Social security insurances are comprised of five categories of

contributions: pension, medical, work-related injury, unemployment, and maternity insurance. The contribution ratio of social security insurance and housing fund for the employer and the employee varies from location to location.

d) *Termination of employment*

There is no "at-will" termination in China. The employer can only terminate an employee relying on limited statutory grounds, such as serious violation of the employer's policies, incompetence, mass layoffs due to economic reasons, etc. The employee may claim double severance pay or reinstatement of employment in the case of a wrongful termination.

The statutory severance pay is calculated based on the service years of the employee with the employer. The employer shall pay to the employee his/her average monthly wage for each full year's service, and half of his/her average monthly wage for service of less than six months. The average monthly wage of an employee means the average wage of the employee during the twelve-month period before the termination of the labor contract. It is also subject to a cap calculated based on the local average monthly wage where the employer is located.

e) *Foreign employee*

Foreigners are required to obtain work permits for the purpose of working in China. The employer is not allowed to sign a labor contract with a foreign employee that has a term of more than five years. When a foreigner enters into China, he/she is required to apply for a residence permit to the local public security department. The foreigner needs to re-apply for the work permit if he/she changes the job. A foreigner will have thirty days to leave China after de-registration of the work permit if he/she is no longer working for a Chinese domestic company.

f) *Labor union*

An employer in China is not obligated to proactively establish a labor union. However, if there are more than twenty-five labor-union members in the company, they could propose to set up an internal grassroots labor union, and the employer shall not obstruct the unionization initiated by its internal union members. In general, labor unions in China are not considered disruptive and maintain a peaceful relationship with their employers; with only rare exceptions.

8) <u>Compliance</u>

With the development of globalization, China's compliance legal framework and supervision system keeps evolving at a fast pace over the past decade, especially in the field of anti-trust and competition laws, data protection and cybersecurity, and import and export control, etc. The Chinese government's strengthened scrutiny with regard to these areas are not specially designed for FIEs, but such compliance issues may more often be encountered by FIEs due to their foreign elements.

Therefore, while an FIE is navigating in an unfamiliar legal environment in China, it is advisable to understand the regulatory rules for compliance purposes as soon as practicable. It is also recommended that an FIE invest more efforts in building up and continuously strengthening its regulatory and compliance management system to adapt to the increasingly strict regulatory climate worldwide.

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ABOUT US

GAMBOA, GARCÍA & CARDONA ABOGADOS 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. GAMBOA, GARCÍA & CARDONA ABOGADOS has a group of lawyers with national and international academic education, and wide 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.

DOING BUSINESS IN COLOMBIA

1. Preliminary Considerations:

In Colombia, a foreign company is able to 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 to the Central Bank supervision and regulation (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 "Permanent Activities", however article 474 of the Commercial Code contemplates a non-taxative 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 resource-extraction industry and/or any of its areas or services.

5. Obtain a concession from the Colombian Government, 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 aforementioned 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 of these 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 to be 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 has to 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) the designation of 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, who 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 before 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 branch's "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, which must be previously approved by the competent 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 en comandita por acciones).

The incorporation process of a company in Colombia is similar for all types of companies. Entities are constituted by public deed or private document, and they form a legal entity independent of its associates. The document of incorporation must include the type of company that is being constituted, its name, its domicile, a description of the company's purpose and activities to be developed, the amount of social capital, the administrative organs of the entity with their respective faculties, how profits will be distributed, its term of duration, which dispute resolution mechanism is established, among others. Also, said document must come with apostille in case the shareholders do not reside in the country, and must be accompanied by a copy of the identity documents of the shareholders and the people that will be appointed in the management and legal representation positions of the entity. Likewise, some forms shall be submitted and signed by the person who will be appointed as the legal representative.

The entities that are constituted must be registered before the Chamber of Commerce with jurisdiction in the place agreed as registered office and the act of creation must be registered in the corresponding Commercial Registry. Furthermore, a tax registration before the National Direction of Tax and Customs must be made, in order to obtain the company's tax identification number.

It is important to mention that there are no specific requirements in order to be shareholder or director, however, the creation of an entity implies the signing of the social contract (incorporation document), therefore shareholders or directors must be legally able to consent to be bound, that is, to be able to obligate by themselves, under the terms of article 1502 of Colombian Civil Code.

Finally, there are no specific restrictions for foreign citizens to establish companies in Colombia. However, it is necessary to consider that if they are going to perform functions in the company, which would imply residing within the Colombian territory, a study of each particular situation should be done to determine what type of visa they require, whether a work visa or visa of owner partner, depending on the situation. However, it is not required under Colombian legislation that shareholders and / or legal representatives of companies reside in the country.

Now, the main characteristics of each type of corporate 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 Directors and Legal Representative; (vi) Designation of 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 a single 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 into three categories: (i) Authorized or stated capital which represents the total number of subscribed shares plus the amount 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. (ii) 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, 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 the board has 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 at least 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 no less than 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) Designation of 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 in order 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 (incorporation document). 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) Designation of 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 at the moment of 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 their 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", however it may have an indeterminate object; (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) Designation of an auditor, only if the assets or income of the company exceeds 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 paid 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 shareholders consider should apply for dividend distributions. For example, shareholders may 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.)

4. Minority shareholders' rights and protection:

In addition to the legal protections already established in the commercial legislation, such as the right of inspection, the requirement to make certain decisions with a plurality of partners, and the existence of the right of withdrawal or qualified majorities for certain key decisions at the general meeting of shareholders, the commercial legislation brings several protection measures for minority shareholders if their rights are considered violated by the controlling shareholder.

Article 87 of Law 222 of 1995, establishes the possibility for shareholders or associates that represent not less than 10% of the share capital, or any of its administrators of companies, sole proprietorships or branches of foreign companies that as of December 31 of the immediately preceding year register a number of income or assets established by law, to request the Superintendency of Companies to reform the clauses of the bylaws that violate legal norms, as well as the practice of administrative investigations when they are presented irregularities or legal or statutory violations. Companies that do not comply with the requirements related to the assets, can resort to the dispute resolution method of conciliation before the Superintendency of Corporations to resolve the conflicts which arise between the associates, or between them and the society. However, any of these implies fulfilling a procedure and a series of additional requirements.

Likewise, in accordance with the provisions of article 191 of the Commercial Code, administrators, fiscal reviewers and absent or dissident partners may challenge the decisions of the assembly or the board of partners which

are product of the abuse of legal or statutory powers of the highest social body. Said challenge may be brought before the judge or arbitrator, as agreed by an arbitration clause in the bylaws, or before the Superintendency of Corporations (in the case of supervised companies).

5. 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. This form must include information such as the company's tax identification number, the legal representative's information, the amount of money that is being transferred and exchange rate, among others. 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. Form No. 6 is particularly used when the funds are brought as Contributions for future capitalizations.

The profits and dividends to be distributed and thereafter paid to the parent company also need to be registered before the Central Bank, through the corresponding form.

6. Conclusions and Recommendations:

In order to determine which mechanism is the best for establishing 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 existing regulations as of October 2021.

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 García Piñeros (dgarcia@gclegal.co)

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CORDERO & CORDERO ABOGADOS

ESTABLISHING A BUSINESS ENTITY IN COSTA RICA

ILN CORPORATE GROUP

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About Us

Cordero & Cordero Abogados is a full-service law firm that specializes on Business and Corporate Law, Foreign Investment and Free Trade Zone Law.

This firm established in 1940, with offices in San José and Guanacaste, has earned its reputation as a top tier law firm preferred by local and international clients doing business in Costa Rica. *Cordero & Cordero Abogados* has been ranked by international directories such as Chambers & Partners as well as other regional bar associations.

The firm's staff is made up of high level, experienced and multilingual attorneys capable of dealing with complex matters and transactions in all of the following practice areas: Corporate and Contract Law; Foreign Investment & Free Trade Zone Law; Information Technologies & Telecommunications; Real Estate; Mergers & Acquisitions; Banking, Project Finance & Insurance Law; Civil Litigation Practice; Intellectual Property; Labor & Immigration, Energy & Infrastructure Law.

1. Types of Business Entities in Costa Rica

The most common types of business entities in Costa Rica are Corporations, known as Sociedades Anónimas (also referred to as "S.A."), and Limited Liability Companies, known as Sociedades de Responsabilidad Limitada (also referred to as "Limitada" or "Ltda."), which are governed by the Costa Rican Code of Commerce.

The Costa Rican Code of Commerce also establishes three other business forms: Sole Proprietorship Companies, also known as "One Man Companies"; Partnerships; and Collective Name Companies. No additional reference will be made to these types of business forms since they are less used in Costa Rican business practice.

The following summarizes general characteristics, basic steps and requirements and obligations for both corporations and limited liability companies in Costa Rica.

2. Corporations (Sociedades Anónimas)

2.1 Incorporation

All corporations must be incorporated before a Costa Rican Notary Public by a minimum of two natural persons, two corporations, or any combination thereof.

2.2 Capital Stock

The corporation is formed by the paid in capital contribution of the founding partners, in the form of Capital Shares, which will reflect the distribution of the paid capital amongst the partners. In order to increase (or reduce) the Share Capital, corporation must follow the guidelines and requirements established in the Costa Rican Code of Commerce.

- Minimum Capital Stock: There is no minimum authorized capital stock required for a corporation. Most corporations start up with a ¢10,000.oo capital stock (approximately. US$20.oo).
- Currency: The capital stock in a corporation can be established in a foreign monetary unit.
- Transfer: Shares are assigned by mere endorsement and by registering the assignment in the entity's Shareholder's Record Legal Book. The assignment of shares does not need acceptance by the assignee.

2.3 Responsibility

The shareholders´ legal responsibility in the Corporation is limited to the amount of capital shares belonging to each.

2.4 Administration

A Board of Directors composed of at least a President, Secretary and Treasurer shall administer the corporation. The legal representation, as well as typically a full power of attorney, are granted to the President, in accordance with the Commercial Code, but such powers of attorney may be limited in their amount and functions, as decided by the shareholders. Other powers of attorney may be granted to other members of the Board. The positions outlined above are the minimum necessary in order to establish the entity; nevertheless, this does not exclude the possibility of appointing vice presidents, vocal (member at large), etc.

2.5 Comptroller

It is required to appoint a Comptroller that will be in charge of supervising the actions of the Board of Directors. Thus, the Comptroller cannot be related to any of the members on the Board of Directors. Also, the Comptroller cannot be a shareholder and will have no power of attorney to act on behalf of the corporation.

2.6 Resident Agent

If none of the Directors that are vested with the legal representation of the Corporation are domiciled in Costa Rica, the Corporation must appoint a Resident Agent who must be a lawyer with an open office in Costa Rica. This appointment is in order to receive legal notifications or notices on behalf of the company.

2.7 Shareholders´ Assemblies

The shareholders´ assembly is the maximum body of authority of the corporation and it is empowered to decide on all matters, including any amendments or modifications to the articles of incorporation, increasing, or reducing the Corporation's Share Capital, granting powers of attorney, appointing, and revoking persons as members of the Board of Directors, etc.

2.8 Minority Rights

The protection of minority shareholders is stipulated in Title I, Third and Seventh Chapters of the Commercial Code. Said regulation establishes as "minority shareholders" those that own shares that equal to or less than ten percent (10%) of the share capital. Based on the above, the following details the rights of minority shareholders:

- Right to examine books, correspondence, and other documents of the corporation. Also, they may examine documents and contracts of those transactions that involve the acquisition, sale, mortgage, or pledge of assets of the company that represent a percentage equal or greater than 10% of the total asset. In this sense, minority shareholders representing at least 10% of the share capital can appear before a Judge to order an auditing of the company.
- Right to request information during shareholders' meetings, such as, but not limited to, reports and clarifications regarding topics that are on the agenda. If this information is requested by Shareholders representing at least 10%, there will be no excuse for not providing the information on said grounds.

- Right to receive a report on the results of the company's annual fiscal year (approval of the financial statements) presented by the directors at the ordinary (annual) shareholders meeting.
- In those cases, in which the Shareholders´ meeting has agreed to pay dividends the partners will have the right to collect the dividends agreed upon, within a maximum period of three months after the meeting in which said dividends were agreed.
- The Board of Directors or must approve prior to the sale, acquisition, mortgage, or pledge of assets of a company that represent a percentage equal to or greater than 10% of its total assets. Likewise, the obligation is regulated that any transaction of the company that involves the acquisition, sale, mortgage, or pledge of assets of this company with the general manager, with some of the members of the Board of Directors or with related parties must be previously reported to the Board by whoever is involved in the transaction, providing all the relevant information about the interest is of the parties to the transaction.
- Right to Recess, which consists of a technical resource that gives protection to minority shareholders, without requiring any minimum percentage to exercise it. This entails, that every member may withdraw from the company before any substantial modification or any resolution that generates an increase in their liability and may obtain reimbursement of the real value of their shares. In accordance with article 32 bis, there are five cases in which the Right to Recess could be applied, namely: (i) Extension of the Social Term; (ii) Transfer of the Social Domicile to the Foreigner; (iii) Transformation or Fusion; (iv) non-distribution of profits in two consecutive periods in which there have been profits; and / or (v) Change of turn or object. Although this is a little known and applied right in practice, it is an important tool for minority shareholders should they request it.

3. Limited Liability Company (Sociedad de Responsabilidad Limitada)

3.1 Constitution

This type of business organization is a hybrid between a Partnership and a Corporation, and it is known as “Sociedades de Responsabilidad Limitada” or “S.R.L.”, or limited liability companies.

3.2 Ownership

The capital stock in a Limited Liability Company unlike Corporations, is not represented by shares but by what are known as “quotas”.

- Minimum Capital Stock: The quotes on a Limited Liability Company are required to have a value each of at least 100 Colones, Costa Rican legal currency.
- Currency: The capital stock in a Limited Liability Company cannot be established in a foreign monetary unit.
- Transfer: Unlike the shares of a corporation that can typically be easily transferred, the transfer of ownership of a quota holder is limited by the following rules:
    - Quotas may only be transferred with the unanimous consent of the remaining quota holders. This limitation can be lowered to a maximum consent of seventy-

five per cent of the quota holders;

- Quota holders may oppose a transfer and thus a right of first refusal would be constituted for the other quota holders to acquire the quotas under the same conditions as they were offered to third parties. If the quota holders do not exercise this option during the subsequent fifteen days, the transfer may be carried out to the third party;
- In order to be effective, all transfers of quotas must be granted in a private or public document, registered in the Company's quota holder Registry Book.

3.3 Responsibility

The personal liability of a quota holder is limited to his or her paid-in capital contribution to the company.

3.4 Administration

The management of a Limited Liability Company is much simpler than that of a corporation, since it only requires a minimum of one Manager to oversee the Company's administration. The Manager will be the legal representative of the representation of the Company and his powers of attorney can be limited as is desired by the quota holders in the quota-holders assembly. The positions outlined above are the minimum necessary in order to establish the entity; nevertheless, this does not exclude the possibility of appointing other Managers of Sub-Managers.

3.5 Quota holders Assembly

The Quota Holders Assembly is the maximum body of authority, and in the same manner as Shareholders Assembly in corporations, it is empowered to decide on all matters. Nonetheless, since Limited Liability Companies are not required to appoint a Comptroller, the Quota Holders Assembly will be in charge of this function.

3.6 Minority Rights

Minority Rights in Limited Liability Companies are the same as in Corporations, as stated in section 2.8.

3.7 Resident Agent

A Limited Liability Company must also appoint a Resident Agent, if none of the Managers that represent the Company are domiciled in Costa Rica.

3.8 Steps and requirements to establish a Corporation

Firstly, all Corporations and Limited Liability Companies must be constituted before a Notary Public by a minimum of two natural persons or two corporations, or any combination thereof. Secondly, the Notary Public must proceed to submit the following information required to register the company through an online platform, namely:

- Name of the corporation: Also referred to "razón social" or "denominación social": The name can be in any language, nonetheless the name may not be identical to any registered entity in the Public Registry. Also, the name of the corporation may be the corporate identification number assigned by the online platform. The same must be preceded by the words "Sociedad Anónima" or its abbreviation "S. A. " or

"Sociedad de Responsabilidad Limitada" or its abbreviation "Limitada".

- Domicile: A registered office must be assigned, and an address must be specified.
- Term: The term may an unlimited number of years.
- Object: The object can be specific or general.
- Capital Stock: Must be issued pursuant to section 2.2 for corporations and pursuant to section 3.2 for Limited Liability Companies.
- Board of Directors or Managers.
- Comptroller: Only for Corporations as stated in section 2.5.

Once registered, corporations will be assigned a corporate identification number, which will serve to identify the corporation in all its acts, known in local legislation as the "Cédula Jurídica" or Corporate Identification Number. This number will be issued by the online system upon registration.

4. Basic Tax Aspects

Entities shall only pay taxes over income generating activities located in Costa Rica. Corporate Tax rates shall apply. Before an entity begins any commercial operation, it shall be registered before the Tax Contributor Registry (*Registro de Contribuyentes*). Also, all inactive entities (not registered as income and/or sales taxpayers with the Tax Administration), must also be registered before the Tax Authority as inactive and must declare all its assets, liabilities, and capital stock.

The income tax is regulated by the income tax law N° 7092 ("Ley del Impuesto sobre la renta") and its regulation ("Reglamento a la Ley del Impuesto sobre la renta, Decreto Ejecutivo N° 18445-H")

Additionally, there was a tax reform called "Ley de Fortalecimiento a las Finanzas Públicas" N° 9635 which entered into force last year (in July 2019); therefore, the income tax law must be read and analyzed in conjunction with the tax reform law.

A tax is established on the profits of natural persons, legal entities, and collective entities without legal personality, domiciled in the country, who develop lucrative activities of Costa Rican source.

The taxable event of the income tax is the receipt or accrual of revenues in cash or in kind, continuous or occasional, from lucrative activities of Costa Rican source, as well as any other income or benefit from a Costa Rican source non excepted by law.

After the enter into force of the new tax reform on July 1st, 2019, the tax period changed, now the tax period is according to the calendar year (it starts January 1st and ends December 31st of every year).

4.1 Corporate Tax

The Corporate tax shall be paid on an annual basis and shall be paid on or before January 31 of each year. The amount paid is related to the gross income of the entity. For 2021, the amounts to be paid were:

- Inactive entity: 69,330.00 colones (USD **$112** approximate)
- Active Entity income less than 54 million colones: 115,550.00 colones (USD **$186** approximate)
- Active Entity income between 54 million colones and 129 million colones: 138,660.00 (USD **$223** approximate)
- Active Entity with income above 129 million colones: 231,100.00 (USD **$372** approximate)

The Tax payment can be made in any of the

banks of the Costa Rican Banking System and can be paid through the Internet banking managed by any bank of preference. If the legal representatives or owners do not have Costa Rican bank account the payment can be arranged through a local contact (property manager, accountant and/or attorney). It is important to keep the receipt for your record.

4.2 Bookkeeping System

All tax contributing entities are required have a proper book-keeping system. All tax contributing entities will have 3 accounting books known as *"Diario", "Mayor"* and *"Inventarios y Balances"*. The accountants are in charge of keep these books updated. Entities are not obligated to hire auditors or have an auditor in staff. This is a standard practice once the company is actually operating a business.

4.3 Annual Tax Declaration

All tax-contributing entities are required to file an annual tax declaration form (D.101) at the end of every fiscal year. The accountants are the persons in charge of preparing this form. However, a confirmation by the auditor is not a formal/legal requirement. The only formal requirement is to have the declaration form signed by the legal representative of the company. If the company is not actively operating and the income generated is "zero", then this form may be completed and filed (with the legal representative's signature) by anyone. Once the form is duly signed the accountant may pay the taxes and file the form on behalf of the entity. Inactive entities (not registered as income and/or sales taxpayers with the Tax Administration) are not required to file a declaration form, but such requirement is expected to change in the last quarter of 2021.

4.4 Transparency and Beneficial Ownership New Registry.

In accordance to By Laws of Registry and Transparency of Final Beneficiaries #410140-H of April 5th, 2018, , all entities, including legal persons and legal arrangements such as, but not limited to companies, trusts, foundations, partnerships, and others, must disclose and report to the Costa Rican authorities who are the natural persons that ultimately are the owners / controllers of the legal persons or legal arrangements, either through their ownership interests, through positions held in the legal persons or legal arrangements. This requires including the ownership chain all the way to natural persons, including disclosure of Holding Companies, Trusts, Institutions, or others involved. Certain formalisms must be fulfilled and could trigger and limit each entity on their future ability to operate. The purpose of this registry is to reach international standards on transparency.

5. Other considerations.

It is of the utmost importance to realize that becoming the owner and/or part of a foreign entity may have an impact on one´s tax responsibilities. Seeking proper advise at the home country becomes a must in these cross-border interactions.

6. Foreign Investment, Thin Capitalization, Residency Restrictions

6.1 Foreign Investment

Costa Rica encourages and enables domestic and foreign entities to establish businesses through various institutions such as the Foreign Trade Promotion Corporation (PROCOMER), Costa Rican Investment and Development Board (CINDE), Tourism Institute (ICT), and others. Nonetheless, there are some limitations, such as:

- There are several areas known as legal monopolies that belong to the public sector, for example public transportation services.
- In areas such as medical series, communication and insurance, state entities take over, though there is no limitation for private entities to compete.

6.2 Thin Capitalization Rules

Costa Rica does not have specific "thin capitalization rules". However, there are limits on the payment of interest by a Costa Rican Limited Liability Company to its members and/or head office. These rules do not apply to a Corporations (Sociedad Anónima), only to Limited Liability Companies (Sociedades de Responsabilidad Limitada).

6.3 Remitting funds out of jurisdictions

Residents of Costa Rica as well as non-residents are taxed on their income only if it originates from a Costa Rican source. Consequently, income received from or generated from foreign sources is not taken into consideration when calculating the taxes to be paid either by individuals or corporations. All persons who carry out commercial activities and all corporations must register before the Costa Rican Tax Authority as taxpayers.

Notwithstanding the above, payment of dividends by local companies to foreign individuals or companies established abroad is subject to a 15% withholding tax.

6.4 Residency

6.4.1 Residency as an Investor

A foreigner can only apply for this type of residency if he/she has and may demonstrate investments in Costa Rica for at least USD$ 200,000. If the investment is in specific areas such as tourism, reforestation, and/or any other activity supported by the Costa Rican government the investment may lowered to an amount between USD $80.000,00 - USD $100.000. Also, a foreigner may apply for this type of visa if he/she one or more properties in Costa Rica that sum up to a $200,000 worth or more.

However, a new law passed for the Attraction of Investors, Rentiers and Pensioners, with special incentives for the next five years. This law requires the drafting and approval of an administrative regulation by the Executive Branch to develop the content of the law, and such regulation may be expected by the last quarter of 2021. The new law reduces the amount of required investment to apply for residency status from US$200,000 to US$150,000 in real estate, registrable assets, shares, securities and productive projects or projects of national interest. Furthermore, some additional incentives include duty free for household items, exoneration from import taxes, and exoneration from 20% of the total transfer tax of real estate.

6.4.2 Companies Accredited as a "Recognized Company"

Companies that require a constant migration flow in their plan of operation of active employees or executive level employees may be accredited before the General Direction of Immigration. To request this recognition a company must be registered before any of the following institutions:

- Companies that are operating under special plans to promote exportation, administered by the Ministry of Foreign Trade (COMEX) and the Promoter of Foreign Trade of Costa Rica (PROCOMER). If the company is registered under this institution it will be classified to request the application as Company under **Classification "A".**

- That has the support of COMEX, by explicit references to organizations with proven track record, national or international level. If the company is registered under this institution it will be classified to request the application as Company under **Classification "B".**
- That is acting with the statement issued by the tourist Costa Rican Tourism Institute (ICT). If the company is registered under this institution it will be classified to request the application as Company under **Classification "C".**
- That are registered with one of the following agencies: the Superintendence of Financial Institutions (SUGEF), the Superintendence of Pension(SUPEN) and the Superintendence of Securities (SUGEVAL). If the company is registered under this institution it will be classified to request the application as Company under **Classification "D".**
- Company under **Classification F:** The multinationals that do not belong to the classifications described above, characterized by having a name or brand whose history is known worldwide, in which the main corporate offices have decided the establishment of a subsidiary in Costa Rica, whose line of operation is developed in areas of production and marketing of goods and services.
- Company under **Classification G:** Those foreign or national companies that are operating or will start operations in Costa Rica and were hired and duly awarded by the Costa Rican government through the processes of Government Contracts.

The requirements will vary and depend on the classifications stated above. Once registered the companies will be able to request residency permits for the employees before and if the General Direction of Immigration will accept or deny their applications through an expedite process that usually takes between 1-3 months.

Furthermore, a new law was passed to promote the attraction of workers and service providers that are carried out remotely, to promote long-stay visitation in Costa Rica and increase the expenditure of resources of foreign origin in the country. Therefore, a new migratory category of non-resident, subcategory of "estancia", Worker or Remote Service Provider. The new law entered in effect in August 2021. But it is important to indicate this law requires the drafting and approval of an administrative regulation by the Executive Branch to develop the content of the law.

The new migratory category will be granted for one year, extendable for a single period of one additional year. To authorize said extension, the beneficiary must have stayed in the country for a minimum of 180 days during the year originally granted. Some incentives are total exemption from the income tax, exempt from paying all taxes on the importation of basic personal computer, validity of driver's license from beneficiary's country of origin, and may open savings accounts in the banks of the national banking system.

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ESTABLISHING A BUSINESS ENTITY IN CYPRUS

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ESTABLISHING A BUSINESS ENTITY IN CYPRUS

Introduction

Cyprus is an EU member state and a common law jurisdiction with a legal system similar to that of the UK. It is located at the eastern end of Europe linking 3 continents, Europe, Africa and Asia and it has a long and strong reputation as an international business center.

1. Types of Business Entities

The most common forms of business entities established in Cyprus are (a) limited companies; (b) partnerships; and (c) alternative investment funds. Further, Cyprus international trusts are also commonly formed by non-Cypriot investors and high net worth individuals.

1.A Companies

Cyprus companies are registered under the Companies Law, Cap.113 as amended.

Private Company Limited by Shares

The private company limited by shares is the most common form of entity established in Cyprus. It has legal personality separate and distinct from its shareholders with the liability of shareholders limited to the unpaid amount of their subscribed shares. There is no requirement for a minimum share capital and generally there is no restriction as to its ability to carry on business activities even where its share capital is small.

The company's governance is regulated by the Companies' Law and the provisions in its memorandum and articles of association which may be adjusted as wished by the shareholders to reflect their arrangements.

Key features

- Separate legal personality.
- Full and unlimited capacity.
- Possibility to adjust articles as per shareholders' agreement.
- Limited liability of shareholders.
- No minimum capital requirement.
- Between 1 and 50 shareholders.
- Can have a sole director or more directors.
- No restriction as to nationality or residence of shareholders or directors.

Tax

- Exemption from tax on profits from the disposal of securities (wide definition of what constitutes eligible securities).
- Exemption from tax on dividend income (subject to certain conditions).
- No withholding taxes on repatriation of dividends, interest, and royalties to non-residents.
- 12.5% corporate tax rate.
- Notional Interest Deduction (annual tax expense calculated as a percentage of equity).
- Extensive and continuously growing network of double tax treaties.

Private Company Limited by Shares registered also as Foreign Interest Company

A Cyprus company can employ third country (non-EU) nationals if it meets certain basic requirements under a scheme adopted by the Cyprus Council of Ministers. These employees can be issued employment and residence permits to work and live in Cyprus. The main requirements are the following:

- The majority of the company's share capital must be held by third country national(s).

- Investment of €200.000 should be made in the company.
- The company should operate in independent offices in Cyprus.

After 5 years of residence and work in Cyprus (or after 4 years if they hold a certificate of knowledge of the Greek language) third country nationals can apply for Cyprus citizenship.

Foreign highly skilled employees in Cyprus can enjoy tax exemptions for up to 17 years which can include 50% income tax exemption where salary is at least EUR 55.000 per year.

Public Company Limited by Shares

A public limited liability company is similar to a private company in terms of its features. It must have at least seven shareholders and a minimum share capital of EUR 25.629.

Unlike a private company, a public company is permitted make offerings to the public and can be listed on the stock exchange upon satisfying certain criteria.

1.B Partnership

Partnerships are regulated by the Partnerships and Business Names Law Cap. 116, as amended, and they may be formed either as general partnerships or limited partnerships.

In a general partnership all partners have unrestricted liability for all obligations of the partnership. In a limited partnership at least one partner is treated as a general partner and has unrestricted liability for the partnership's obligations, with the other partners having limited liability up to the amount contributed (or remaining unpaid) by them to the partnership. Since 2015, a limited liability partnership (LLP) can also be established.

Partnerships are not considered to be separate legal entities and therefore, profits generated by a partnership are taxed as income received by the partners.

1.C Fund

With the enactment of the Alternative Investment Funds Law of 2018, Cyprus has modernized its legal framework regulating the registration and operation of alternative investment funds ("AIFs").

The law permits the registration of AIFs which are self-managed (by their board of directors) or externally managed by a fund manager and may be registered with Unlimited Number of Persons or with Limited Number of Persons, or as "Registered" AIFs.

An AIF may be formed as a company with a fixed capital, a company with variable capital, a common fund, or as a limited liability partnership with or without legal personality.

Key features

- Various legal forms available, including tax transparent ones, to meet investor wishes.
- Cost-efficient and simple to set-up, manage and operate.
- Modern regulatory framework fully in line with relevant EU directives.
- Full transparency through annual audited and half yearly reports to CySEC and investors.
- Reduced reporting requirements.
- Generally, no restrictions imposed by the Regulator on type of investments.
- May be self-managed (subject to the approval of the Regulator).
- May be set-up as umbrella funds with multiple compartments.

- May be listed on Cyprus Stock Exchange and other recognised EU stock exchanges.

Tax

- Most income of a Cyprus tax resident fund is tax free (most dividend income, capital gains).
- Interest income is taxable, but effective tax can be significantly reduced (considering the NID on new equity).
- Services provided by the investment manager of the fund are not subject to VAT.
- No withholding tax on payments to non-residents.
- No subscription tax on net assets of a fund.
- No capital gains tax on disposal of shares/units by the holders.
- No tax on capital gains from the sale of immovable property located outside Cyprus.
- Extensive network of Double Tax Treaties in place with more than 60 countries.

1.D Cyprus International Trust

The legal framework governing trusts in Cyprus is a combination of English Law i.e., the Principles of Equity and local legislation i.e. The Trustees Law (Cap 193) and the International Trusts Law of 1992 as amended.

The International Trusts Law has created one of the most attractive trust legal frameworks in the world. It offers the opportunity to create trusts to suit complex circumstances and provides also other important advantages.

The settlor of a Cyprus International Trust (CIT) and the beneficiaries must not be tax residents in Cyprus during the year preceding the year of creating the CIT (they may become tax residents subsequently). At least one of the trustees must be Cyprus resident.

Key features

- CITs may be challenged only on defraud of creditor grounds with a 2-year limitation period.
- CIT matters are determined under Cyprus Law and Cyprus Courts have jurisdiction.
- The Settlor can reserve powers including powers to revoke or amend the trust, to appoint and remove trustees, to change the law regulating the CIT and others.
- A CIT may last for an indefinite period.
- The income of a CIT may be accumulated without limitations.
- The law regulating a CIT may be changed to another foreign law.
- The trustees of a CIT are bound by confidentiality.
- CITs are generally transparent for tax purposes.
- Capital gains tax applies only regarding gains from the disposal of real estate situated in Cyprus or shares of a company holding property situated in Cyprus.

2. Steps and Timing to Establish

2.A Company

The incorporation of a Cyprus company is straight forward and comparatively easy. It can usually be completed in approximately one

week to ten days. The company's name must be first approved by the Registrar of Companies and thereafter, the memorandum and articles of association of the company signed by the shareholders together with statements signed by the directors are submitted for registration.

2.B Partnership

A partnership exists as from the day on which it commences business. It must inform the Registrar of Companies within 30 days of commencement so that its existence be registered.

2.C Fund

Except where a fund is established as a "Registered Fund" where no licensing is required, in all other cases funds must obtain approval from the Cyprus Stock Exchange Committee. The application process is fairly simple and quick and can be completed within a couple or few months.

2.D Trust

The trust is effective as from the time it is declared and signed by the settlor. The trust instrument must be stamped, and the trustee must notify the relevant competent authority (being either of the Cyprus Securities and Exchange Commission, the Cyprus Bar Association, or the Cyprus Association of Certified Accountants) within fifteen days from the creation of the trust, to lodge it in the Cyprus Trust Registry.

3. Governance, Regulation and Ongoing Maintenance

3.A Company

Governance

Companies operate in accordance with the provisions of the Companies' Law and those in their memorandum and articles of association.

The Companies' Law provides for certain matters which are to be decided by the shareholders. Such matters include the change of the company's memorandum or articles of association, the change of its name, the reduction of its share capital and its liquidation.

It is possible by addition of provisions in the articles to require that further matters are to be decided by the shareholders, and/or to require higher majorities than those provided by the statute for the decisions of the shareholders to be passed.

The way proceedings of the directors are to be conducted and the quorum and majorities required for their decisions are regulated by the provisions in the articles of association.

The articles of association of a company may be amended by shareholders' resolution passed with at least 75% majority of the persons entitled to vote and present at the meeting (subject to anything further that may be provided by the company's articles of association).

Minority protection

Protection to minority shareholders is afforded by mandatory provisions in the Companies' Law which cannot be bypassed by contract or provisions in the articles. Such provisions include the right to call meetings, to obtain certain information and to block the passing of decisions unless the majorities provided by the law are satisfied.

Since the articles of association can be adjusted to reflect the shareholders' arrangement, it is possible to include in them provisions which provide to the minority further protection (for example veto rights, requirement for increased majorities, tag-along and drag-along provisions and other mechanisms to deal with possible deadlocks).

In addition, protection to the minority is afforded by the Companies' Law which permits oppressed or unfairly treated shareholders to apply to the Court for an order to remedy the situation.

Foreign shareholders and directors

The shareholders and directors of a Cyprus company may be non-Cypriots. The secretary of the company must be in Cyprus.

Compliance obligations

Cyprus companies must in each year hold annual general meetings, prepare audited financial statements, submit an annual return, and pay an annual levy of EUR 350.

3.B Partnership

Partnerships operate by decisions of their partners passed in accordance with the partnership agreement. They must keep books of accounts and for this purpose partners (except for LLP partners) must keep proper accounts in a manner necessary to present or explain their transactions. When the taxable income of a partner exceeds €70.000 then audited accounts must be prepared.

3.C Fund

Funds operate in accordance with the provisions in their articles of association, their investment policy and prospectus, and the law. The governing body of an AIF or its external manager must consist of a certain minimum number of natural persons who must have executive function (depending on the type of AIF, this minimum number varies from two to four).

The registered office and business offices of all types of AIFs must be in Cyprus. In certain cases, AIFs must appoint a local depositary and appoint a compliance officer. Filing and reporting obligations that an AIF must comply with on a monthly, quarterly or an annual basis, vary depending on its type.

3.D Trust

The settlor of a Cyprus International Trust and the beneficiaries must not be tax residents in Cyprus during the year preceding the year of creating a CIT. At least one of the trustees must be Cyprus resident.

Trusts are managed by their trustee in accordance with the mandatory provisions of the law and the provisions in the trust instrument which can regulate what powers the trustee has and to what restrictions his powers are subject. It is possible in the trust instrument, the settlor to reserve powers, or to otherwise restrict the ability of the trustee to take certain actions with the trust fund. Where a protector is appointed and the trust instrument requires his consent for certain type of decisions, the consent of the protector must be obtained.

There is no statutory obligation to prepare or file audited accounts for the trust. The trustee in the exercise of its duties must keep proper books of accounts.

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

4.A Foreign Investment & Thin Capitalisation

There are generally no restrictions on investment in Cyprus by foreign investors. Foreign persons can be both shareholders or directors in Cyprus companies/entities without being needed to obtain approval or license.

Under the Cyprus tax regime thin capitalization rules do not apply. There is no withholding tax on payments to non-residents and generally, exemption applies from tax on profits from the disposal of securities (with a wide definition of what constitutes eligible securities) and from

tax on dividend income (subject to certain conditions).

Where a third-country national wishes to acquire directly in his/her own name real estate property in Cyprus an approval must be obtained from the district office. This is mostly an administrative process and does not apply where the investor purchases the property through a Cyprus company in which he/she is the shareholder.

The anti-money laundering laws and regulations (harmonized with EU relevant laws) must in any case be satisfied for a person to conclude transactions in Cyprus.

4.B Residency

Where a person is not an EU citizen, there are two main schemes which may be pursued for obtaining residence permit in or through Cyprus.

Fast Track Permanent Residency Scheme

Fast track scheme, under which an applicant by investing €300.000 (plus VAT) or more in a residential property in Cyprus (or other eligible investments such as units in Cyprus registered investment funds) can, within a period of about two (2) months, obtain a permanent Cyprus residence permit. The permit can be granted to the applicant and his/her spouse, to their "dependents" and parents, valid for their entire lifetime.

Cyprus Foreign Interest Company

A Cyprus company (which may be an ordinary private limited company by shares) can employ third country (non-EU) nationals if it meets certain basic requirements. These employees can be issued employment and residence permits to work and live in Cyprus.

To utilize the scheme, the majority of the company's share capital must be held by third country national(s), an investment of at least EUR 200.000 should be made in the company and the company should operate in independent offices in Cyprus as per the relevant regulations.

Visa Entry

The following categories of nationals can travel to Cyprus freely and do not require an entry visa:

- EU nationals (including Liechtenstein, Switzerland, Iceland, and Norway).
- Holders of certain diplomatic passports.
- Ship crews.
- Holders of Schengen multiple entry visas and/or residence permits issued by a Schengen member state (including Romanian or Bulgarian authorities).

All other foreign nationals must apply for one of the following visa types:

- Short-Stay Visa allowing foreign nationals to enter Cyprus for a maximum of 90 days within a six-month period (for travel or business, excluding immigration).
- Multiple Entry Visa allowing foreign nationals to enter Cyprus on multiple occasions for up to a maximum of 90 days in any given six-month period. Usually, this type of visa is valid for a maximum of five years.
- Border Issued Visa (granted in exceptional circumstances).
- Long-Stay Visa allowing nationals to remain in Cyprus for a period of up to one year.

Fall 21

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.

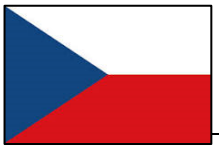
The company is owned by one or more individuals or corporations. Each shareholder holds an "ownership interest" which corresponds to a percentage of the total registered capital. An LLC with a sole shareholder can also be the sole shareholder or founder of another limited liability company.

The company itself is wholly liable with all its assets for any breach of its obligations. 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. 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 with all its assets for any breach of its obligations. 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.

In addition to 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 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 licences 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

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

2. Steps and timing for establishment

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.

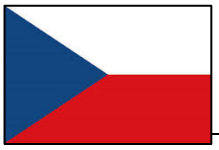
Founding a company does not mean it legally exists. In the period between its foundation and establishment, the company does not have legal personality (it cannot acquire rights or obligations) and its statutory bodies do not yet exist. Company shareholders are only in the position of founders and not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

The Company's founders must authorize 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. As of 1 January 2021, it is possible, if the amount of all cash deposits into the limited liability company does not exceed CZK 20,000, to repay a cash deposit in a way other than through a special bank account, for example, by using a deposit manager to accept cash or through current accounts. This change makes it cheaper and faster to set up and create low-cap limited liability companies. 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 licence (such as a trade or other licence). The trade licence is certified by an extract from the Trade Register held by the Trade Licensing Office. The company acquires the trade licence, 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, authorized 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.

3. 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.

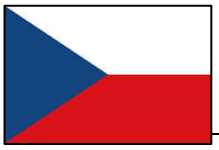
For capital companies, the supreme body is always the general meeting of shareholders.

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. The Memorandum of Association or Foundation Deed may however extend the list of prohibited activities or, conversely, shorten it, to exclude all restrictions altogether, or to determine the conditions under which their exercise will be prohibited. 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 only a board of administrators. Business management is therefore executed either by a board of directors (in the dualistic model) or by an administrative board (in the monistic model), which also performs a supervisory role and decides on the strategic orientation of the business management (until 31 December 2020 in the monistic model the business management was vested mainly to the statutory director and the supervisory role to the board of administrators).

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 rigid in the Czech Republic. 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, 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.



There is an 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 to avoid a situation where his/her performance of the office will be for free which is generally the case when no contract on performance of office has been concluded and approved by the general body of the company.

Since 1 January 2021, this rule of free performance of office was adjusted so that if such contract is invalid or ineffective or no contract for the performance of office has been concluded for reasons on the side of the company, vis major or generally another reason independent of the will of the member of the statutory body, the member is entitled to the usual remuneration.

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 Collection of Deeds held by 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.

3.3 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 authorized 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.

3.5 Registration of beneficial owners

All business corporations are obliged to register their beneficial owners with the particular Register of information on beneficial owners of legal entities ("**Register**").

As of 1 June 2021, a brand-new Act on the Registry of the Beneficial Owners of legal entities ("**Act**") became effective and brought significant changes in this area.

The beneficial owner of the company is a natural person who has (individually or jointly with other person(s) acting in concert) a share exceeding 25% of benefit of the company or exercises end influence in the company according to the Act on Business Corporations. Moreover, when there is no natural person who meets the criteria described above, the members of top management of the company, or if the company belongs to a group of companies, of the ultimate parent company, shall be registered with the Register as its beneficial owners *per fiction*.

The members of the statutory body of the company are responsible for identification and registration of beneficial owner(s) with the Register as well as keeping internal records on them. They shall also proceed with any changes therein without undue delay. The beneficial owners as well as other legal entities in the ownership structure are obliged to provide the company with all necessary support for the registration.

The following data of the beneficial owners of companies are to be registered with the Registry (i) full name, residency address, nationality and date of birth of beneficial owner, (ii) detailed description of his/her position as beneficial owner within the company, (iii) amount of his/her share or other information, if the position of beneficial owner is not based on his/her share (iii) description of the relations in the structure of the group of legal entities, if such structure exists and (iv) the day since when the person became beneficial owner and the day when the person ceased to be the beneficial owner.

There are several types of access to the data registered with the Register. In general, only the name, nationality, month, and year of birth of the beneficial owner, the day since he/she became beneficial owner and a brief description of his/her position are available to the public, other data can only be obtained based on particular authorization or a justified request.

If the company fails to register its real beneficial owner(s), the public authority may initiate proceedings against it in order to eliminate discrepancies.

Various sanctions such as fines up to CZK 500,000 (approximately EUR 19,500) may be imposed on the company, beneficial owner or even on entities in the ownership structure. The exercise of voting rights and of the right to receive distributions is prohibited to a beneficial owner who is not registered with the Register and/or to shareholders of a legal entity with no duly registered beneficial owner(s).

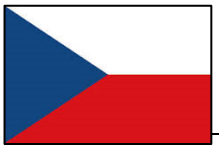
4. Foreign investment, thin capitalization, residency, and material visa restrictions

4.1 Thin capitalization rule

Thin capitalization 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 capitalization 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

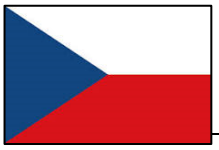
Withholding tax is applied to certain types of income earned by Czech tax residents and to a number of Czech-sourced types of income earned by Czech tax non-residents. The tax rate is 15 percent. However, the withholding tax rate applicable to the Czech sourced income of Czech tax non-residents as stipulated 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 DTT 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.

Taxpayers 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 88 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 Harmonization 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 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 parent company if it is a tax resident of Switzerland, Norway, Iceland, or Lichtenstein.

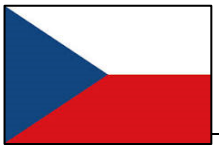
4.7 Further corporate tax exemptions

Tax exemptions for dividends and other profit share distributions have been extended to profit share distributions paid to a Czech tax resident (and 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 are 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, the same as Czech nationals, in regard to commencing work or taking up a position as a statutory body member with a Czech company. For such purposes 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 an 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

Regulation (EU) 2018/1806 of the European Parliament and of the Council 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.

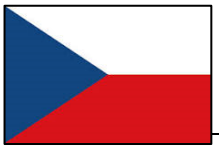
Third-country nationals not subject to the visa obligation may stay in Schengen states for up to 90 days within a 180-day period from their first entry. The duration of individual stays in different Schengen states cumulates.

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 the 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 90 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 the 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 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 authorized under a power of attorney, to the relevant Labour Office, generally before his/her 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.

Covid-related restrictions may have an impact on immigration services and requirements and are to be checked in particular cases.

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This memorandum is for information purposes only and reflects the law on 25 August 2021.

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 Krbcová (krbcova@peterkapartners.cz).

PETERKA & PARTNERS is a full-service law firm operating in Central and Eastern Europe providing one-stop access to an integrated regional service.

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

DAHL LAW FIRM

ESTABLISHING A BUSINESS ENTITY IN DENMARK

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN DENMARK

1 TYPES OF BUSINESS ENTITIES

There are several forms of business entities in Denmark and there are a wide range of possibilities for establishing a business entity in Denmark. The most suitable entity depends on a variety of factors, such as nature of the business, the expected activity level, the extent of liability and tax matters. The following will review different possibilities of establishing business entities in Denmark.

1.1 Limited Companies

The limited companies are characterised by the shareholders liability is limited to the capital invested in the company. The shareholders will not be liable for the obligations of the limited company. The shares in the Public Limited Company (Aktieselskab – A/S) may be offered to the public. It is only the Public Limited Company which can be listed on a regular or alternative market. The Public Limited Company is also the most regulated entity in Denmark. The nominally share capital in the Public Limited Company must be at least 400,000 DKK and the nominally share capital in the Private Limited Company (Anpartsselskab - ApS) must be at least 40,000 DKK. The Private Limited Company is quite similar to the Public Limited Company, but the Private Limited Company is less regulated, and the company cannot be listed on a regular or alternative market. The limited companies are the most common entities for foreign investors.

1.2 Sole Proprietorship

A Sole Proprietorship (Enkeltmandsvirksomhed) can only be owned by one physical person. The entity is suitable for smaller business. The person who owns the entity is personally liable for the business, which implies, that the person is liable for all debt and obligations of the business. The person who owns the entity has the full control over all business decisions. There are no capital requirements for establishing an entity as a Sole Proprietorship and there are only a few legal requirements.

1.3 Partnerships

The partnerships can be organised with limited liability for the participants and with unlimited liability for the participants. Partnerships require more than one participant. The structure is more flexible than the limited companies. The different partnerships are tax transparent.

The Partnership (Interessentskab – I/S) is a partnership of minimum two participants. The persons' who own the partnership are personally liable for the business, which means the persons are joint and severally liable for all debt and obligations of the business. There are no capital or other requirements for the establishment of the partnership besides the partners having an agreement.

The Limited Partnership (Kommanditselskab – K/S) requires two types of participants, the "Komplementar" which is the participant who is personally liable for the debt and obligations of the partnership and the "Kommanditist" which are the participant(s) who are limited liable and only liable for the contributed share capital. There are no capital requirements for the establishment of the Limited Partnership.

The Partnership Limited by Shares (Partnerselskab – P/S) requires two participants, the "Komplementar" which is the participant who is personally liable for the debt and obligations of the partnership. The Komplementar will often be a limited company, which makes the liability illusory. The "Kommanditistaktionær" are participant(s) who are organised as shareholders in a Public

Limited Company (A/S). The Partnership Limited by Shares is governed by the Danish Company Act and the regulations which applies to the Public Limited Company also applies, to the Partnership Limited by Shares with modifications. The nominally share capital in the Partnership Limited by Shares must be at least 400,000 DKK.

1.4 Branch office

It is possible to establish a branch, to carry out foreign entities business in Denmark. Companies which can operate through a branch in Denmark must be a foreign:

a) public limited company,

b) limited partnership company,

c) private limited company or

d) a foreign company with a similar corporate form based in an EU/EEA country or a country, which has an international agreement with Denmark.

The branch must be managed by a branch manager, which has the power to bind the branch, by its signature. The foreign entity is liable for the obligations of the Danish branch office. The branch offices must be registered with the Danish Business Authorities. The Danish Business Authorities requires certain information about the foreign entity. It can take up to weeks to establish a branch in Denmark. The entity "Branch offices" will not be covered or elaborated any further.

It is also possible to establish other entities in Denmark besides the above mentioned such as Cooperative Societies (A.m.b.A), European Company Societas Europea (SCE-selskaber), European Cooperative Society (SE-selskaber) and Commerical Foundations (Erhvervsdrivende fonde) etc. which will not be covered any further.

2 STEPS AND TIMING TO ESTABLISH

2.1 Limited Company (A/S, ApS)

Limited Companies are commonly used business entities in Denmark. The entities are governed by the Danish Company Act which among other things regulates the requirements for the establishment of the companies.

The founders of a limited company must initially sign a memorandum of association and articles of association. There is no requirement for notarial certificates. The documents must be submitted to the Danish Business Authorities with the request for registration of the company, within two weeks after the formation of the company. The formation of a limited company will be effective from the day of signing the memorandum of association and the articles of association or from any later date specified in the memorandum of association.

The share capital can be paid with cash, assets, or both. The limited company cannot be registered if the shareholders have not paid at least 25 % of the share capital (not less than 40,000 DKK) if the contribution is cash. This possibility is therefore mostly relevant for the Public Limited Company. The possibility of not paying the whole share capital implies restrictions.

There must be an evidence that the share capital has been paid before the time of the registration.

The company will hereafter be registered by the Danish Business Authorities and the company receives the Company Register Number (CVR-no.) often within one (1) weekday from uploading the request, if the registration is selected to manually review by the Danish Business Register which often occurs by random sampling, the CVR-no. may take between one (1) to four (4) weeks to

receive. It is possible to buy an "of the shelf" company, which is already registered but taking the quick online registration into consideration, this possibility is very rarely used.

2.2 Sole Proprietorship (Enkeltmandsvirksomhed)

When establishing a Sole Proprietorship there are no formal requirements for the establishment. The entity must be notified to the Danish Business Authority but the notification itself does not have any legal effect. After notifying the Danish Business Authority the Sole Proprietorship will receive its registration number (CVR-no.). The owner of the Sole Proprietorship is the tax subject of the entity and the income, and the deductions shall be registered in the owner's income tax return. The Sole Proprietorship must register for paying Danish VAT, if selling goods or services.

2.3 Partnerships (I/S, K/S, P/S)

The Partnership (I/S) is established by an agreement of establishing a business between the partners. There are no formal regulation concerning the agreement. The partnership is *not* regulated by the Danish Company Act, which means it is highly recommended, to have a partnership agreement which regulates the terms of the partnership. The partnership must be notified to the Danish Business Authority but the notification itself does not have any legal effect. If the Partnership is owned by two legal entities the partnership will be registered in the business register with legal effect. The Partnership will receive its registration number (CVR-no.) hereafter. The owners of the partnership are the tax subjects of the Partnership and the income, and the deductions shall be registered by the owner in the owner's income tax return.

The Limited Partnership (Kommanditselskab – K/S) is established by a Limited Partnership Agreement. The capital contribution from the Kommanditist can be cash or assets. It is not a requirement that the company capital has been contributed before the formation of the Limited Partnership. The Komplementar must have some administrative powers such as signing for the company, veto rights and economic rights such as receiving payment or dividend due to the liability. The partnership must be notified to the Danish Business Authority but the notification itself does not have any legal effect. The partnership will receive its registration number (CVR-no.) hereafter. If the Partnership is owned by legal entities the Limited Partnership will be registered in the business register with legal effect.

The Partnership Limited by Shares (Partnerselskab – P/S) is established by establishing a new or a converted existing Public Limited Company to a Partnership Limited by Shares. The Kommanditistaktionær must at least contribute at least 400,000 DKK to the share capital in cash or assets. It is possible if the contribution is in cash, to only contribute with 25 % of the share capital, just as the Limited Companies. The Komplementar does not have to contribute with cash or assets. The founders of the Partnership Limited by Share must sign a memorandum of association that states who the Komplementar is and articles of association. The Komplementar must also have some administrative powers which could be appointing a member of the board and economic rights such as receiving payment or dividend due to the liability. The documents must be submitted to the Danish Business Authorities with the application for registration of the company within two weeks after the formation of the company. The formation of the Partnership Limited by Shares will be effective from the day of signing or from any later date specified in the memorandum of

association. The Partnership Limited by Shares will hereafter be registered by the Danish Business Authorities and receives the Company Register Number (CVR-no.) often within one (1) weekday from uploading the application. If registration is selected to manually review by the Danish Business Register which often occurs by random sampling, the CVR-no. may take between one (1) to four (4) weeks to receive.

3 GOVERNANCE, REGULATION AND ONGOING MAINTENANCE

The companies and partnerships are obligated to inform the Danish Business Authorities of the legal- and beneficial owner of the company or partnership if the legal owner owns more than 5 % of the shares or voting rights and the beneficial owner that holds more than 25 % of the indirect shares, voting rights or has other decisive influence over the entity. There are no specific restriction concerning local shareholders or directors in the companies and partnerships in Denmark.

3.1 Limited companies (A/S, ApS)

The limited companies in Denmark are governed by the Danish Company Act. The limited companies are obligated to report changes decided at the companies' general meetings, such as changes in; the management, name, accountant, nominal capital, entity address, new articles of association etc. to the Danish Business Authorities.

The Danish Company Act requires a "Two-tier system" for the Public Limited Company, which means the shareholders can choose between;

a) board of directors which has the responsibility for superior management and the board must appoint one or more executive manager(s), who is responsible for the daily management. The board of directors must consist of at least three (3) members and the chairman must not be the executive manager and the executive managers may not constitute the majority of the board or

b) one or more executive manager(s) who is responsible for the management, the management is appointed by a supervisory committee who supervises the management. A member of the supervisory committee cannot be a member of the management.

The Private Limited Company can choose between the "two-tier system" and a "one-tier system". The one-tier system consists of one or more executive manager(s).

The Danish Company Act contains several minority rights. The most common will be reviewed as follows. The minority of at least 33,33 % of the share capital or of the voting rights can oppose changes in the articles of association, share capital increase, reduction of share capital, liquidation of the company, merger, and fission etc. The minority that is at least 10 % of the representatives at the general meeting, can abstain from losing "inalienable rights". A minority of at least 5 % can require notice of an extraordinary general meeting. There are also individual rights such as having a question debated, to talk or to ask questions to the management at the general meeting.

3.2 Partnerships (I/S, K/S, P/S)

The Partnership Limited by Shares is regulated by the Danish Company Act and the same regulations as the Public Limited Company apply.

There are no company legislation regulating the Partnership and the Limited Partnership besides minor articles in the Danish Act on Commercial Undertakings (in Danish: lov om visse erhvervsdrivende virksomheder) concerning the name of the partnership and powers of procuration. There are some facultative provisions set out by case law and

principles of general company law regulating the Partnership and the Limited Partnership. Concerning the Partnership, the executive power is partly at a) the Partnership meeting and b) partly by the owners. All questions on the partnership meeting must be agreed upon jointly since the owners has the right of veto. The minority protection is extensive due to the unlimited liability. The management in the Limited Partnership is mostly the Komplementar due to the unlimited liability. Decisions which do not comprise the Limited Partnership Agreement or the purpose of the Limited Partnership must also be accepted by the Kommanditister.

It is recommended to have a comprehensive partnership agreement due to the absent legislation concerning the Partnership and the Limited Partnership. On the other hand, the great freedom of the structure and regulation of the entities can be an advantage for some businesses.

3.3 Safekeeping of company documents

The management of the companies (ApS, A/S and P/S) are obligated to safekeep all company documents in 5 years after the financial year which the documents concerns. Company documents could be memorandum of association, articles of association, minutes of meeting of the general meeting etc.

The management is likewise obligated to safekeep the entity's accounting records in 5 years after the financial year, which the accounting records concerns.

4 FOREIGN INVESTMENT, RESIDENCY AND MATERIAL VISA RESTRICTIONS

4.1 Significant barriers to entry for an offshore party

There are no specific restrictions or barriers concerning foreign investors establishing Danish entities which does not apply to Danish investors, beside entities engaged in taxable activities registered outside the EU must be registered though a liable representative in Denmark, if the entity is established in third countries which Denmark has not entered an agreement with concerning mutual assistance based on EU legislation. There will apply some restrictions, permits, licenses and authorisations for some businesses.

4.1.1 VAT

A foreign entity established in Denmark is subjected to the VAT regulation in Denmark after the same regulations as other Danish entities. The entity must register for paying Danish VAT and the entity must declare VAT for each VAT period.

4.2.2 Tax

A Danish company must, by default pay tax to the Danish Tax Authority for profit generated by the company. The company tax rate in Denmark is 22 %. The taxation of the company depends on potential double taxation agreements in case two or more countries has the right to tax the profit.

A Danish limited company owned by a foreign investor, or a foreign entity can also be obligated to pay tax to the Danish Tax Authority of profit generated by the entity in Denmark due to being permanent established in Denmark.

Employees must withhold Danish Tax and labour market contribution to the Danish Tax Authorities from the salary of services carried out in Denmark – this also covers foreign entities who have employees who have been working in Denmark. The entity must as the employer, withhold Danish Tax and labour market contribution to the Danish Tax Authorities from the salary that the entity pays from the services carried out in Denmark.

4.3 Special business or investment visa issues

It is not necessary for investors to have a visa to invest in Denmark. If the owner would like to work or live in Denmark, a residence/- or work permit might be necessary. Visas are issued for the purpose of stays less than three (3) months and employment is not permitted during the stay. For residence/- or work stays which is longer than three (3) months, a residence-/ or work permit is required. Special rules apply to citizens from Nordic Countries, the EU members States, Switzerland, and Liechtenstein. It is advised to seek specific guidance concerning visa, residence/- or work permit issues.

4.4 Restrictions on remitting funds out of the jurisdictions

Danish entities distributing dividends must report information about the recipients of dividends to the Danish Tax Authorities. There are no specific restrictions on remitting funds out of Denmark, but the funds may be applicable to taxation. The taxation of the distributed funds depends on whether Denmark has entered an agreement with the foreign country concerning the avoidance of double taxation. This section concerns the situations where Denmark has the right to tax the distributed funds.

The entities are obligated to withhold the tax of the distributed dividends to individual persons and to companies.

4.4.1 Partnerships distributing funds

In partnerships the profits and losses are distributed equal between the partners. The different partnerships are taxational transparent and the individuals will be subjected to paying tax if receiving funds from the partnership. Denmark has the right of taxation if the activity is qualified as a permeant establishment in Denmark (such as a branch office). If the activity is not qualified as a permeant establishment, the taxation depends on the regulation in the country the participant is domiciled in.

4.4.2 Limited Companies distributing dividend

The taxation of the distributed dividend depends on a variety of factors and to some extent it depends on the percentage of ownership in the company distributing the divided.

If the shareholder is an individual person, the person will be subjected to paying tax of the distributed dividend. The taxation rate is 27 % of the amount of 56,500 DKK (2021) and the taxation rate is 42 % for the dividend which exceeds 56,500 DKK.

The limited companies: Shareholders that are limited companies and owns less than 10 % of the shares in the company distributing shares, will always be subjected to taxation of the distributed shares. It is only 70 % of the distributed shares which will be taxed with 22 % if the company is not professional investing in shares.

For shareholders that are limited companies (in accordance with Danish law) and owns more than 10 % of the shares in the company distributing shares, the company can to some extend receive the dividend without the dividend being taxed. There are following requirements:

a) the foreign company owns more than 10 % or more of the share capital of the Danish company or more than 50 % of the voting rights,

b) the company receiving the dividend is the beneficial owner,

c) the company is Danish, or the company is foreign, and the EU Parent-Subsidiary Directive applies, or the subsidiary is resident in a

country which has entered a double taxation agreement with Denmark.

The limited companies that do not fulfil the above-mentioned conditions must withhold 22 % to the Danish Tax Authorities when distributing dividends, unless Denmark has entered a double taxation agreement where it is stated that the taxation of divided should be 15 % or a percentage less than 22 %. The company receiving the dividend may in that situation apply for a refund of the overpaid tax from the Danish Tax Authorities.

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This guide is provided for informal purposes and must not be perceived as legal advice.

If you have any questions concerning the Establishment of a Business Entity in Denmark, please do not hesitate to contact our office.

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DAHL Law Firm is one of Denmark's largest law firms with more than 200 employees. We provide first class legal advice to clients of all sizes nationwide, ranging from small businesses to large corporations and government agencies. This is delivered with the unique combination of professional breadth and great expertise, which is one of the features of DAHL Law Firm.

Many of our specialists are among Denmark's leading experts in their respective fields. When dealing with large and complex problems, they cooperate across, and contribute their own, specialist expertise. DAHL Law Firm is therefore a strong legal partner, also in the very largest commercial cases.

For further information please visit our webpage www.dahllaw.dk.

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INTERNATIONAL LAWYERS NETWORK

CONSORCIO LEGAL

ESTABLISHING A BUSINESS ENTITY IN ECUADOR

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN ECUADOR

ABOUT US

We are a Law Firm which applies a new concept in legal services, allowing our clients to have access to all fields of law, both nationally and internationally; at reasonable costs and with optimal results. We count on the best and most trustworthy in-house and external fully dependable experts in each specialization of practice.

We are a socially responsible, flexible, dynamic, client-focused organization oriented toward growth and recognized for excellence in the legal services field by creating measurable value for our clients in the accomplishment of their legal service needs through the unique application of innovative, consistent and dependable services.

We work with clients and prospects openly, honestly, and sincerely. When we say we will do something, we will do it; when we say we cannot or will not do something, then we will not do it. We get results for our clients.

We are satisfied with nothing less than the very best in everything we do.

We embrace the use of technology to help us run our practice and improve the quality of services we provide our clients. Keeping up with tomorrow is as important as being great today.

We treat clients, opposing counsel, Court staff and Judges as we would like to be treated ourselves. We do not tolerate abusive or disrespectful treatment.

We take the time to talk with clients and with one another... and to listen. We believe that information is meant to move, and that information moves people.

Our wide range of services goes from the Administrative public law procedures; corporate and commercial; civil in general, family, and hereditary successions law; real estate; trusts and investments; contracts; public works biddings; tax law; alternative dispute resolution; litigation.

We combine experience and youthfulness to carry on and achieve effective results.

CONSORCIO LEGAL advises corporate and individual clients of all fields of businesses and industries. We handle pro-bono cases.

1. **GENERAL INTRODUCTION:** In Ecuador, foreign individuals or corporations in general are permitted by law to invest, except in the so called “strategic sectors of the economy”: electricity, water and sewage, highways, airports, ports and railways infrastructures, oil, and others. However, those fields can also be given in concessions or associations by the State for a certain period of time and by payment to the State of a royalty according to the respective contracts negotiated with the State after the corresponding biddings.
2. **BENEFITS AND EXEMPTIONS OF TAXES:**
   a) Ecuador offers a **TOTAL EXEMPTION of income tax** in ALL NEW INVESTMENTS, whether local or foreign, for 12 years, in the following fields, as long as they are located in other locations than Guayaquil and Quito (in order to foster the development of other areas of the country, and not only in the two main cities):
      - Farming sector: fresh, frozen, and industrialized foods production;

- Forestry and agroforestry chain of production and its elaborated products;
- Metal – Mechanics industry;
- Petrochemical, Oil-chemical and Pharmaceutical industries;
- Tourism, Cinematography, audio-visual and international events activities;
- Renewable energies including bioenergy or energy derived from biomass;
- Logistics foreign commerce Services;
- Applied Biotechnology and Software; and,
- Export of Services.

NOTE: there are some other regions besides the main cities, where investments can be made and are in fact done. Two of them are the surroundings of the beautiful Andean City of Cuenca, at a 3 hour, and the Pacific Coastal Region at 1 ½ hour ride; all by excellent highways.

If the investments are made in the main cities of Quito or Guayaquil, **the exemption is for 8 years**.

b) It also offers **total exemption** of the Currency Exit from the Country Tax (ISD) of 5%, in all payments made abroad for the new productive investments based on investment contracts; on account of import of raw materials and capital goods necessary for the project; and for dividends distributed by national or foreign corporations domiciled in Ecuador, in favor of beneficiaries resident in Ecuador or abroad; as long as the investment resources (funds) come from abroad and the investor demonstrates the receipt of funds to the country.

c) Likewise, the corporations which **re-invest in Ecuador** at least 50% of its net profits in new productive assets are exempted from payment of ISD in the

distribution of benefits to beneficiaries resident in Ecuador.

d) **Total exemption of income tax for new investments in basic industries:** for the sectors that contribute to the change of the energetic matrix, to the strategic substitution of imports, to foster exports, as well as the rural development of any section of the country, and of the urban zones **(for 15 years)**; and the deduction of 100% of the annual cost of yearly depreciation. Besides, those investments made in the depressed sections of the country will be also allowed a deduction from income tax of 100% of the cost of salaries paid to new labor force in those regions, also for five years. F

For those projects so called **APP (Public-Private Associations)** for the construction of public works like highways, bridges, transport means, etc. (all public works and services), they can get exemption from income tax, ISD tax, and foreign commerce taxes (in general) according to each case analyzed and resolved by the corresponding Ministry (Official Entity) of Ecuador in negotiation with the investor; for **10 years**. In the APP´s model the investment is

done by the investor after a clear bidding process, and the investor gets back his investment in tolls authorized by the State at the biding process, in such a way that the investor gets back his investment and gets an adequate profit from the project. This is one of the preferred models right now, by which ports and other facilities are being built, remodeled, or drilled, and which has some multinationals working in Ecuador, one of them our client.

Also, the projects of **Social Interest Housing** (construction of low middle-class people houses) will have the exemption benefits.

The new investments in micro, small or medium size entrepreneurships in community or associative tourism will have an exemption of income tax for **20 years.**

3. **FORMS OF ESTABLISHMENTS OF BUSINESSES. -**

a) Individual business with a RUC (Taxpayers Unified Registry) with no minimum or maximum of capital. Usually for individuals who want to establish a small business.

b) Limited Liability Company with a minimum of 2 and maximum of 15 partners. Mostly used for small and medium size businesses. Minimum capital **$400**. There can also be unipersonal limited liability companies.

c) Stock Company, minimum capital **$800**; shareholders from 2 up with no limit.

In both Limited Liability and Stock Companies, foreign investments do not require previous approval of any Governmental entity.

d) Other forms of association are the General and Limited Partnership Companies, less used as they imply personal responsibility of partners.

e) There are also Joint Ventures Associations, usually for development of specific projects with the State (two companies, either local or foreign, for the execution of a public work or service contract). They abide by the provisions of the respective contracts.

All corporations are controlled by the Superintendence of Companies, Securities and Insurance; they must file yearly balance sheets, Minutes of approval of them, and lists of shareholders or partners; as well as update designation of Company executives. This is besides the obligation to present balance sheets to the RSI (IRS) together with taxes declarations and payment if appropriate.

4. **TAXES RANGE. -**

Income Tax 25% over net profits. 3% additional if shareholders or partners in the chain of owners are residents of a fiscal Paradise or of a jurisdiction of less tax range. In order to calculate the net tax there are deductions that have to be done, all the necessary expenditures to run the business.

5. **DOLLARIZED ECONOMY. -** Ecuador has been a US dollar economy since 2000; so there is no inflation, and acquisition power of the people are much better than when we had our own currency, the Sucre. People are much better off; they can get cars, houses, electrical appliances, with rather small monthly payments according to their respective economies.

6. **WAGES. -** The so called basic salary is around $500 a month including social benefits, plus around 20% of contribution to the Social Security which is shared with the worker 50% - 50%. Basic salaries are readjusted yearly by the Government, private Enterprise and Workers Commission each January.

   Besides, workers are entitled to a yearly 15% of the net profits of the businesses, divided by all workers (workers´ participation of profits).

   In order to foster the incorporation of new businesses into the commercial activities of both locals and foreigners, the SUPERINTENDENCE OF COMPANIES as Control Entity has approved new regulations which allow the INCORPORATION OF SAS ("Sociedades por Acciones Simplificadas" – "Simplified Stock Companies") that can be incorporated in <u>one day and with no minimum stock capital</u>.

7. **PUBLIC SERVICES. -** They have very much improved the last 15 years. All is done online. Provision of electricity, water and sewage is optimal. Ports, airports, highways and roads are also very good. Banking is very mucha ahead of many other countries.

8. **WEATHER** is mild and breezy, not rainy almost eight months of the year (June – November), rainy and very warm, sometimes hot from January to May –in the Coast; the Andean Section where the Capital City is and there are beautiful landscapes, rather cool, sometimes cold and rainy, others warm. The Oriental Section of the Country is rather warm or hot, full of forests, very good roads to ride. The Galápagos Islands are a fantastic place to visit.

   Ecuador is one of the preferred places of the world to retire. Most retired US and European citizens have acquired real estate around the City of Cuenca in the Andean Section, and on the Pacific Ocean Beach resorts.

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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 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 with many other western European countries; investors benefit from a business friendly environment as well as a high degree of legal certainty and political stability; and 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 continental 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 the UK. It is meant as an introduction to the UK 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 by you or your business, 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 25 August 2021, but please bear in mind that statutes, regulations and rules are subject to change.

The UK comprises England, Wales, Scotland, and Northern Ireland. Great Britain comprises England, Wales, and Scotland.

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, e.g., company law and tax, the law is the same or very similar but in some, such as real property, it is very different. We are able to identify areas which need input from lawyers in Scotland or Northern Ireland and to arrange appropriate advice.

The UK left the European Union (**EU**) on 31 January 2020 and the transition period ended at 11.00pm on 31 December 2020. During the transition period, although the UK was no longer an EU member state, most EU law and regulation, as well as the laws of England and Wales, continued to apply in full.

From the end of the transition period the European Union (Withdrawal) Act 2018 (**EUWA**) created retained EU law, i.e., a new body of law based on EU law that applies in England and Wales (alongside the laws of England and Wales). Going forward, the UK can decide whether to introduce new UK policies or whether to mirror EU policies in UK law. UK law must be compatible with the terms of the withdrawal agreement, future agreements with the EU and other countries.

Setting up a business in the UK is quite straightforward. 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 the UK:

- by forming a private limited company (Limited) or a public limited company (Plc);
- by establishing a branch (a so-called "UK establishment");
- by forming a partnership (limited partnership, limited liability partnership or 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 and Wales is likely to be influenced by taxation considerations (which are not addressed by this guide), company law and other legal matters. Fladgate LLP has a wealth of experience in these matters and will be happy to give any legal and tax advice which may be required in connection with establishing a UK operation and in dealing with the necessary legal procedures.

1.1 Formation of a company

This section sets out the requirements for incorporating a private limited company in England and Wales (**company**) (as the wholly owned subsidiary of a foreign company). The public limited company form (mainly used for a company quoted on a stock exchange) is chosen only for a small number of companies and 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. Note that a foreign investor will be treated the same as a UK investor from a company law perspective.

There are two ways of incorporating a company: either by forming a new company

or by buying a company that has already been formed, known as a "shelf company".

Articles of association

A company must have articles of association (**articles**), which represent its constitution. UK legislation provides model articles for use where a newly formed company has not drawn up its own articles.

Share capital

Usually, a company will have a share capital. The share capital is made up of shares that have been issued and allotted to its shareholders (also called "members"). Each share will have a nominal value. As no minimum nominal value is laid down by law it can be as little as £0.01 or less. Frequently the nominal value of each share is £1. The share capital can be in any currency, for example euros (€), or it may be made up of various currencies.

A company formed under the Companies Act 2006 is not required to state its authorised share capital in its articles. All it has to do, when applying for registration with Companies House, is to notify the initial capital and to send in a notification each time new shares are issued.

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

A company needs only one shareholder. The shareholder may be an individual or a company and does not need to be UK resident or incorporated in the UK.

Company name

The name of a company must end with the word "Limited" or the abbreviation "Ltd", unless a special exemption, available for non-commercial purposes only, has been granted.

The proposed company name must not be the same as any existing company 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.

Fladgate LLP can run a check of a chosen company name, to ensure that it is available and capable of being approved.

Directors and company secretary

A company must have at least one director who is an individual. There are a few restrictions on the choice of directors, for example, a director must be at least 16 years old, may not be disqualified from acting as a company director and may not be a bankrupt individual. Directors may be of any nationality.

There is no longer any legal obligation for a company to appoint a company secretary, although one may be appointed. The company secretary keeps the company's records and ensures that the company complies with the main provisions of company law. Where a company has foreign owners, it may be advisable to appoint a company secretary.

Registered office

A company must have a registered office in the UK 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 (ending on 5 April).

Special approval requirements for a company

It should be noted that running the business of a company or branch in the UK may require certain trading licences or other approvals. For example, the formation and the operation of a financial services business will usually require authorisation from the Financial Conduct Authority. Fladgate LLP can advise you if authorisation requirements apply to your business.

1.2 Establishing and operating a branch (UK establishment)

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

There are some registration requirements relating to both the foreign company and the branch that have to be completed within one month from opening the UK establishment.

1.3 Limited Liability Partnership

It is possible to form a limited liability partnership (**LLP**) in the UK. 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 between a company and a partnership.

LLPs are particularly popular with professional service providers (e.g., lawyers and accountants) and in the fund and asset management sector. Whereas a company is already quite user-friendly by international standards, an 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

Foreign nationals may also establish a partnership (**general partnership**) in England, although the partners will have unlimited liability.

Another possibility is to form a limited partnership (**LP**). In contrast to the LLP, in England and Wales, the LP has no 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 may be a limited company. LPs are especially preferred by investment funds. They are neutral for tax purposes and are not taxed separately.

1.5 Using commercial agents

As an alternative to forming a 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 or her 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 ventures

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

1.7 Buying or acquiring an interest in a company (M&A)

As an alternative to forming a new company, the foreign business may buy an established company or purchase shares in it. This is certainly the quickest way of gaining a business foothold in the UK. M&A is an entire topic in itself, on which Fladgate LLP can advise if required.

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 with the Registrar of Companies at Companies House. This information will be available for public inspection. Failure to comply with these requirements is a criminal and/or civil 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", i.e., 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,

and the company must not be excluded from the "small companies' regime".

Registers

In addition to the filing of the information with the Registrar of Companies, English company law requires a company itself to maintain a number of registers, such as a

register of members (or shareholders), register of directors etc.

Further both companies and limited liability partnerships are also required 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) more than 25% of the shares or voting rights in a company, having the right (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 a company. A company's PSC register will be open to public inspection in the same way as the register of members. Any change in the person with significant control of the company must be recorded in the PSC register within 14 days of such change and confirmed with the Registrar of Companies within 14 days of the change being entered into the PSC register.

A private company has the option of keeping certain registers, including the PSC Register, at Companies House, instead of separately maintaining its own registers.

Confirmation statement

The company must deliver a confirmation statement to the Registrar of Companies each year. The confirmation 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 (because the appropriate filing has not been made) 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 security

Particulars of most charges or other security created by a company must be notified to the Registrar of Companies within 21 days beginning with the day after the date of their creation.

Other matters requiring registration

The Registrar of Companies must be notified of certain other events in a company's life, including where:

- there are 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, confirmation of his or her details and consent to act must be given by the company;
- shares are allotted, consolidated, sub-divided, redeemed, or repurchased.

Certain resolutions passed by a company, e.g., a resolution amending its articles of association, also have to 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 "Plc", must be set out legibly on all of 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, e.g., invoices, orders, and estimates.

The company must paint or affix its name on the outside of each place of business in easily legible characters and in a conspicuous position.

2.2 Branch (UK establishment)

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 must be notified to the Registrar of Companies within 21 days beginning with the day after the date of their creation. 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, it is still required to file accounts as if it 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 overseas company were incorporated in the UK). Such accounts generally have to 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

An LLP is registered at Companies House and has similar reporting obligations as a company. Typically, the forms used by an LLP are variations of the forms prescribed for a company's use. The main, and probably the most important, distinction is that while 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 at Companies House but only have certain limited reporting obligations.

General partnerships are not registered at 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 (previously, it exercised these rules in conjunction with the now defunct Office of Fair Trading). 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). Following BREXIT, the CMA no longer has powers to enforce Articles 101 and 102 – these are therefore the sole preserve of the European Commission. In practice, the UK rules are interpreted consistently with their EU counterparts and so it makes little difference which of them are applicable to a particular situation.

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 101 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/Article 101 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 and Ofgem in the gas and electricity sector. These authorities (in common with the CMA) have significant powers to investigate suspected anti-competitive activity, including entering and searching business and private premises without any prior warning. 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.

Whilst the UK government operates a largely "merger friendly" regime which encourages corporate activity, does not include any specific governmental oversight of transactions, and leaves the analysis of the competitive impact to the CMA, the government does reserve the power to act where a transaction engages the "public interest". Recently, these powers have been extended to include transactions which involve national security concerns, notably those covering military/dual-use products, computing hardware and quantum technology.

The UK government recently enacted a new National Security and Investment Act (**NSIA**) which, when it comes into force on 4 January 2022, will make transactions in sectors deemed to be of "national or security interest" subject to government oversight, irrespective of the size of the parties. The government has set out a list of 17 such sectors in which it will be mandatory to notify any qualifying transaction. The NSIA applies to entities and assets located in the UK, as well as those located outside the UK if they carry on activities in the UK or supply good to services to people in the UK.

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 requirements in England for a local shareholder or director.

5. Minority shareholders' rights and protections

Members of a company or an LLP 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.

Fladgate LLP 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

EEA and Swiss nationals residing in the UK by 11.00 p.m. on 31 December 2020 were able to continue residing in the UK from 1 July 2021 onwards, if they applied for settled (having resided in the UK for 5 years) or pre-settled status (having resided in the UK for less than 5 years), by 30 June 2021 under the EU Settlement Scheme. There is the possibility to apply out of time however an EEA/Swiss national would need exceptional reasons as to why they did not apply within the deadline. Any EEA and Swiss nationals who do not have status under the EU Settlement Scheme who are arriving in the UK for the first time from 1 January 2021 onwards whether for business, work, study or to live, will be required to obtain an appropriate visa prior to travel.

There are also restrictions on citizens of other countries living and working in the UK, and specific advice should be sought prior to travel. There are visa categories available for those wishing to establish a business in the UK (and be involved in the running of that business) known as the Start-up or Innovator visa. There is also an investor visa category for those wishing to invest a minimum of £2 million in the UK.

All businesses in the UK wishing to hire EEA nationals (who are not already in the UK with either pre-settled or settled status) and migrants from outside of the EEA, will be required to obtain a Sponsor Licence in order to sponsor migrants to work for them in the UK. EEA migrants who were not residing in the UK on or before 31 December 2020 will need to obtain a Skilled Worker visa before being able to enter and work in the UK from 1 January 2021 onwards.

9. Restrictions on remitting funds out of the jurisdiction

9.1 Distribution of profits

Companies/Subsidiaries

There is generally no withholding tax on payments of dividends by a UK company.

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.

Pursuant to some double tax treaties, a non-resident shareholder of a UK company may be exempt in its country of residence on UK dividends.

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. It 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 as deductions in calculating taxable profits of the subsidiary. 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, with an acknowledged expertise in undertaking complex corporate and property transactions, as well as commercial, tax and trust matters and disputes. Clients are drawn from all sectors of commerce and industry and include multinational corporations, public sector bodies, entrepreneurs, and high net worth individuals. We have a substantial international practice, with almost 40% of our turnover having an international dimension. Specialist groups comprising multilingual and multi-qualified lawyers primarily serve continental Europe (with an emphasis on Germany, Switzerland, Austria, and France), Russia/CIS, India, Israel, and South Africa. Other groups focus on the Middle East, the Asia Pacific region, and the US.

Principal Areas of Work

The corporate department advises on listings and flotations, including AIM flotations, funds, M&A, JVs, MBOs and private equity, UK and international corporate and commercial transactions, employment, restructuring, tax, IP and IT, banking, and partnership law. The real estate department advises on acquisitions and disposals, development and construction, funding, investment, secured lending, landlord and tenant, planning and portfolio management. The dispute resolution department handles general commercial litigation, cross-border disputes, international arbitration, professional negligence, corporate and asset recovery, banking litigation, and family and matrimonial.

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Fall 21

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. By the end of 2022, the legislator plans to abolish the minimum share capital requirement for OÜ. 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 exceeds 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 exceeds 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. At the beginning of 2022, an amendment to the law will enter into force, which will also allow branches to be registered electronically in e-

Business Register. 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, Belgian, Lithuanian, and Estonian ID-card holders may establish a company and a branch (starting from January 2022) electronically through the Company Registration Portal ("CReP"). 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.

If none of the members of the management board is a resident of Estonia, the company has to designate a contact person to whom the procedural documents and the declarations of intent addressed to the company may be delivered in Estonia. The list of the individuals or companies that may be appointed as the contact person are as follows: a notary, an advocate, a law office, a sworn auditor, an audit firm, a tax representative and an AML company.

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 offshore 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% or 7% 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.

Generally, there is no withholding taxes on dividends. The income tax at a rate of 7% shall be withheld from the regularly paid dividends (see section 4.5) which are to be distributed to natural persons (both residents and non-residents). Applicable tax treaties may stipulate a lower tax rate.

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. As of 2019, a lower tax rate was 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 (except withholding tax on regular dividends at a rate of 7% distributed to natural persons, see section 4.3.).

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 65 tax treaties in force (the list may be found at: http://www.emta.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 into 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 (see exceptions in sections 4.3 and 4.6). 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.

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 80-100, 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 365 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 365 days during 455-day period, 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. Short-term employment for participation in seasonal work can be registered for up to 270 days during a year.

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. The requirement for the amount of investment does not apply in the case of

start-up company, but in this case the start-up company must be previously evaluated by an expert committee.

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 125 and for a temporary residence permit for business EUR 190. 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

FENNO ATTORNEYS AT LAW

ESTABLISHING A BUSINESS ENTITY IN FINLAND

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN FINLAND

1. TYPES OF BUSINESS ENTITIES AVAILABLE IN FINLAND

The most common forms of business entities in Finland are a limited liability company, a general or a limited partnership, and a co-operative. It is also possible to run a business as a branch of foreign enterprise. Other entities such as associations and foundations also exist, but such entities operate typically on non-profit basis and are not discussed in this overview. A private person may also operate as a private trader.

Matters to consider when choosing a particular business entity type in Finland are, for instance, the taxation, differences in responsibilities and decision-making, operational flexibility, number of people establishing the business, the need for capital and its availability, continuity of operations, attitude of finance providers, profit sharing and covering losses.

Certain commercial activities in Finland are subject to a license; these include the serving of alcohol, debt collection and security guard business. Licenses are also needed in certain industries, such as banking, insurance, investment activities and fund management.

1.1 Limited Liability Company

The present Limited Liability Companies Act (624/2006) (the "Companies Act), which entered into force in 2006, introduced a very modern and flexible company law that allows the rules of the company to be efficiently tailored through the articles of association. Limited liability company (Ltd) can be organized either as a private or public company (Plc). Starting from July 2019, minimum capital requirement was abolished and nowadays a private limited liability company can be established without any share capital, which makes the process quite straightforward. However, the minimum capital requirement regarding a public company is EUR 80,000. The shares of a public limited company may be listed and traded on the stock markets.

Limited liability company may be established by at least one person or organization. The shareholders use the decision-making power and, the perhaps the most important feature is, that the shareholders are not personally liable for the obligations of the company.

A limited liability company is the most common type of business entity in Finland, and it is the recommended form of business when there are several owners and/or when the business is intended to be large scale.

1.2 Private trader

One of the most popular business types nationally is the private tradership, which is the simplest company form and quite easy to establish. Operating as a private trader means that the person establishing the business shall carry out the business operations alone or together with his/her spouse. The private trader is registered only in the name of one person, even when a couple would set up and operate the business together. The registration of a private trader is more of a notification to the authorities that the person shall operate as an entrepreneur. The private trader is an option suited for business operations where there is no need for big investments or capital, such as a carpenter, freelance journalist, massage therapist or photographer etc.

1.3 Partnerships

There are two types of partnerships; a general partnership and a limited partnership. To establish a partnership there must be at least two partners, generally natural people but a partner can also be a legal entity (business). The partners invest a contribution in the partnership in the form of money, assets, or work. General partners are personally liable for the obligations of the partnership, whereas limited (or silent) partners have no such personal liability. At least one of the partners in a general partnership or of general partners in a limited partnership must have a place of residence or, if the partner is a legal person, its registered office in the European Economic Area (EEA). Otherwise, a permit from the Finnish Patent and Registration Office must be applied for all partners that are not from the EEA.

The general and limited partnerships are similar forms of business and in principle, are set up the same way. A general partnership is ideal for a small business with a trusted partner and a limited partnership could be well suited for business activities based on personal work input combined with an investor. One advantage of a partnership form is that the income flows through to the partners and is not taxed at the partnership level, which makes the partnerships the most common form of Finnish closed-end funds (private equity and venture capital funds).

1.4 A Branch of a Foreign Corporation

A foreign corporation or foundation may establish itself through a branch office that runs a continuous business or trade in Finland, from a permanent place of business located in Finland. The branch office is considered an extension of the foreign corporation and it must operate in the same line of business as the foreign entity. The foreign entity is liable for all debts and other obligations as the branch office is not considered to be a separate legal entity as such but a part of the foreign entity.

A branch office is rather easy to establish, and no separate management is required especially when the foreign entity comes from the EEA. The foreign entities outside of the EEA need a license to establish a branch in Finland before registration, whereas foreign entities within the EEA may only register the branch without any separate licenses.

1.5 Co-operative

A co-operative society is a separate legal entity from its members established through registration. A co-operative is an association, which has one or more members. The members may be private individuals, undertakings, or other associations. The main purpose of this type of business entity is typically to allow the members to use the services provided by the co-operative. The members are not personally liable for the obligations of the co-operative. The regulations regarding co-operatives are set out in the Co-operatives Act (421/2013). The co-operative is not usually a suitable form of business for a foreign business.

2. STEPS AND TIMING TO ESTABLISH

2.1 Limited Liability Company

The registration of a limited liability company is quite easy, and notification may be in certain standard cases submitted online. When the limited liability company is being established, the founders register all shares of the company. At least one of the ordinary members of the board and one of the deputy members (calculated

separately) must have permanent residence in the EEA area. If not, a license must be sought from the Finnish Patent and Registration Office for all board members from outside the EEA area.

The founders of a limited liability company must sign and provide specific documents to the Trade Register to establish the company along with the Trade Register notification. These include data forms, memorandum of association and articles of association. Memorandum of association shall include, among others, the initial share subscriptions and the first board members. If a person without a Finnish personal identity code is reported for registration for the first time, a proof of the person's existence must be enclosed (such as a copy of the passport, or an extract from a business register in another country). The company will receive a business identity number at the registration.

2.2 Private Trader

Establishing the firm is simple since no separate founding documents are needed. A private trader must register the business in the Trade Register if the following circumstances exist; trader operates in permanent premises (such as a room separate from home); trader employs people other than spouse or child who is a minor; or trader operates in a licensed field of trade. The private trader must also register for VAT if selling goods or services.

Even though the registration it is not compulsory it might be a wise thing to do since it gives e.g., protection to company name.

2.3 Partnerships

Both types of partnership are founded by a partnership agreement. It is possible to agree in the partnership agreement on, for example, who has the right to represent the partnership, conveyance of the partnership share, resignation from the partnership, distribution of profit as well as termination or cancellation of the partnership agreement. The partnership agreement is supplemented by the provisions in the Partnership Act (389/1988).

For the registration the partnership agreement and personal data forms as well as permits (if applicable) must be provided. After submitting the documents, the company will be registered by the Trade Register and the company receives a business identity number.

In addition to the partnership agreement the partners may also draft a separate partner agreement in writing in connection with the founding of the partnership. The partner agreement may contain specific clauses regarding the administration of the partnership, the decisions requiring unanimity of the partners, distribution of funds, non-competition, and the handling of disputes. The agreement also aims to regulate the liabilities of the partners concerning the debts and commitments of the partnership. Such restriction is not, however, binding on a third party.

2.4 Branch of a Foreign Corporation

The branch office should be registered to the Trade Register prior to starting the business operations. Certain documents must be provided to the Trade Register, including specific forms, evidence of the establishment of the branch and of the appointment of a representative and indication of granting of the right to sign the company name. Also, an extract from the register in which the foreign entity has been entered in its home state or other evidence

of its existence and a Finnish or Swedish-language copy or a legally valid translation of the memorandum of association, articles of association, rules or other corresponding documents of the entity must be provided. If the foreign entity is from outside the EEA a license must be provided and if a new person is entered in the Register and they have no Finnish personal identity code, there must be a proof of the existence of the person (passport or other such document).

It should be noted that the documents needed for the establishment of the branch shall be provided in Finnish or Swedish which means that the documents must be translated. The establishing document of the branch office is usually the minutes of a board meeting regarding the establishment of the branch office. The retrieval of required documents and translations may be time-consuming and expensive.

2.5 Handling times

Founding documents regarding limited liability company and private trader may be submitted online to the Trade Register and then the registration will take only a few days. However, online filing may be used only if certain standard founding documents are used. In other cases, documents must be provided in paper form and the handling will normally take around three weeks, but also faster registration is possible in case of urgency.

3. Governance, Regulation and Ongoing Maintenance

3.1 Private limited liability company

The issues relating to the company are decided by the shareholders in general meetings or by board of directors in board meetings. The decision-making power is divided in relation to the number of shares and the shareholders are liable for the commitments of the company only to the extent of the capital they have invested in the company, unless they have guaranteed loans or other liabilities on behalf of the company. Generally, all shares carry equal rights unless otherwise set out in the articles of association. Share classes and the rights of the share classes can be set out quite freely, for instance non-voting shares are accepted.

The shareholders appoint a board of directors that shall represent the company and take care of the management of the company. The board may also appoint a managing director who can be named during the establishment of the company, or later by decision of a board meeting. If the board comprises of less than three ordinary members, at least one deputy member must also be appointed and if there are several ordinary members, a chairperson must be named. The representation rights of directors and the managing director can be defined in the articles of association.

An annual general meeting must be held, and other meetings must be held if needed. Decisions of unanimous shareholders and board of directors can be adopted without convening any physical meetings, provided the decisions are recorded in writing in the minutes, which makes the decision-making process quite flexible.

Certain decisions, like share issuance or issuance of share options, a change of board members and managing director as well as change of representation rights must be registered to the Trade Register.

Financial reporting

Financial statements and consolidated financial statements must be prepared annually in accordance with the Finnish generally accepted accounting principles (GAAP) or, if the company is listed on the stock exchange, in accordance with the IFRS. The form and the scope of financial reporting depends on the size of the company; small companies are for instance exempt from the requirement to prepare financial statements in accordance with the Finnish GAAP and IFRS. The Financial Statements must be submitted for publishing to the Trade Register four months after the end of the financial period at the latest.

Minority shareholders' rights and protection

The minority shareholders are protected by an equal treatment principle in the Companies Act. Shareholders that represent 10 % of all the shares in the company are further protected by certain minority protection provisions and may for example demand a special audit or election of an auditor, demand that an extraordinary general meeting is held to address a certain matter or demand that a minority dividend is distributed, or they may bring an action on behalf of the company. A minority shareholder can also require a squeeze-out (to redeem the shares of the minority shareholder at a fair price) on a shareholder holding at least 90 % of the shares.

Minority shareholders may waive certain minority rights, which is typically done in a shareholders' agreement. The liability of a shareholder is limited to the value of their shares, but a shareholder may be personally liable if he/she has caused damage to the company deliberately or by negligence by violating the Companies Act or the articles of association of the company.

3.2 Public Limited Liability Companies

A public limited liability company form is typically used for larger companies or listed companies. Therefore, the Companies Act provides certain additional obligations to the public limited liability company concerning the corporate governance and reporting compared to a private limited liability company.

3.3 Partnerships

A general partnership (*in Finnish; Avoin yhtiö, AY*) consists of at least two partners who jointly carry on business based upon the partnership agreement. In this business entity type the partners have an equal status and are personally liable for the debts and other obligations of the partnership. The partners have a personal right and an obligation to decide on the matters of the business. The right is limited however; the field of business is agreed upon in the partnership agreement and a decision regarding activities not in the scope of the business field must be agreed unanimously by the partners.

The purpose of a general partnership is to work towards a joint financial aim, and this requires a high level of loyalty. As mentioned above the capital of the business consists of the contributions of the partners. The contributions may differ in the amount or quality but both partners are entitled to use the assets of the partnership freely. The use of capital assets of the general partnership can be handled in the bookkeeping as distribution of profits, return of equity, private withdrawal or as a loan.

The liability of general partners towards a third party is unlimited. The partners may agree upon a certain mutual arrangement regarding debts and obligations etc. However, a third party has the right to demand payment from any of the partners if the general partnership has not paid the debt, and the personal assets of a partner can be used to pay such debts. The partnership is personal, and it cannot be transferred without the unanimous consent of other partners.

A limited partnership (*in Finnish; Kommandiittiyhtiö, KY*) is similar to the general partnership except that there are two types of partners, general (also called active) partners and silent partners. There must be at least one of each type of partners in the limited partnership. The general partners have the same rights and obligations as in the general partnership described above; they are personally liable for the debts and obligations of the partnership. The liability of the silent partners is more limited, although the partners may agree otherwise in the partnership agreement; the liability of a silent partner may be limited to the amount of the contribution of the partner agreed upon in the partnership agreement. The silent partners receive an agreed interest on the earnings (no "direct" access to funds) and do not have the right or obligation to participate in the decision making.

The general partners may contribute money, assets or work in the limited partnership whereas the silent partner shall invest assets of monetary value in the business and the value is to be declared in the partnership agreement. The silent partner then earns profit for the assets contributed and acts in a role of outside investor and shall have the right to review the bookkeeping of the company.

Note that there must be a continuity of operations and to establish a general partnership for a project, such as construction project, has not been accepted in taxation.

Financial reporting

Financial statements and consolidated financial statements must be prepared annually in accordance with the Finnish generally accepted accounting principles (GAAP). The financial statements must be submitted for publishing to the Trade Register if certain requirements are met: if a general partner is a limited liability company or if the turnover, size of the balance sheet and number of employees exceed certain thresholds.

Liability, governance, and protection

The general partners in both partnership entity types are liable for the decisions, obligations, liabilities, and debts of the business, and thus if one partner makes a commitment, the others are also liable for it. Partnerships are thus considered to be the most suitable option for family enterprises as this business entity type requires a high level of trust among the partners. However, as mentioned above, agreements may be used to limit for example the liabilities of the partners.

The general partners have a personal right and an obligation to decide on the matters of the business which is limited by the scope of business of the partnership. The operations and governance of a partnership are thus quite easy and informal. There are no specific provisions on the administration and governance in the Partnership Act and the partners are quite free to set up the

administration the way they want. The partners' unanimity and the right and obligation to handle matters regarding the partnership are the main governing principles. The general partner has a veto right which means that a partner has the right to prohibit another partner from undertaking an individual measure.

The silent partners do not have the above-mentioned rights, representation rights or veto rights, and usually they act more of as an investor in a partnership.

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

4.1 Significant barriers to entry for an offshore party

There are no significant restrictions on the number or nationality of shareholders. However, restrictions may apply to certain types of businesses.

4.2 Special business or investment visa issues

It is not necessary for investors to have a visa to invest in Finland. If the owner would like to work or live in Finland, a residence or a work permit might be necessary. Visas are entry permits for a short, temporary visit of less than three months. If you plan to work or be an entrepreneur in Finland, you will usually need a residence permit. Special rules apply to citizens from EU Member States, Iceland, Liechtenstein, Norway, and Switzerland.

4.3 Foreign investment

There are no general restrictions on foreign investment but, under the Foreign Corporate Acquisitions Act (2012/172), the Finnish Ministry of Economic Affairs and Employment monitors foreign corporate acquisitions and may restrict them if key national interests require. These key national interests may concern national defense, security of supply or functions fundamental to the society.

The guiding principle of the Foreign Corporate Acquisitions Act is a positive attitude to foreign ownership. The Finnish authorities could, however, exercise control over the ownership of companies considered essential in terms of security of supply and national security and, if necessary, restrict foreign ownership in such companies. As regards the defense material industry, monitoring covers all foreign owners. In other sectors, monitoring only applies to foreign owners residing or domiciled outside the EU or European Free Trade Area.

4.4 Thin Capitalization

In Finland, interest limitation rules have been implemented instead of thin capitalization rules. The deductibility of a company's net financing expenses is limited to 25 % of the adjusted taxable income of the company ('EBITD''). The restrictions on the deductibility of interests apply to all financing expenses, to both group undertakings and external parties. If the total net financing expenses exceed EUR 500,000, the interest deduction limitations will apply. When the total net financing expenses exceed the threshold of EUR 500,000, the deductible net financing expenses are limited to 25% of the company's adjusted taxable income. It should be noted however that, external net financing expenses are fully deductible up to EUR 3 million and will be deducted before internal financing expenses.

4.5 Restrictions on remitting funds out of the jurisdictions

If the receiver is not a resident in Finland and gets dividends, interest or royalties, the Finnish payer must withhold tax at source. The tax at source is 30 percent. Depending on the provisions of different tax treaties, a lower rate - or even a full exemption from taxation - may be applied. Finland may be in an agreement with the foreign country to avoid double taxation, which means that the taxation depends on the provisions of the applicable tax treaty.

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INTERNATIONAL LAWYERS NETWORK

REINHART MARVILLE TORRE
ESTABLISHING A BUSINESS ENTITY IN FRANCE

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN FRANCE

1. Types of Business Entities

- **Description of the types of entities available in each jurisdiction 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 forms of 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 of its rights and obligations constitute the rights and obligations of the foreign company.

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

- **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 of the legal formalities for the incorporation of a company.

A French branch office has no share capital, no articles of association (*statuts*) and does not hold shareholders' meetings; however, it is obliged to file tax returns in France 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

- **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 takes approximately 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*"). The following steps are required:

1. Drafting of the articles of association (*statuts*)
2. Signature of a lease or domiciliation agreement (or letter) for the company's premises or registered address
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 auditors (if any);

(iii) choosing the French bank and operating the transfer of funds.

3. Governance, Regulation and Ongoing Maintenance

- **Brief summary of regulation of each type and ongoing maintenance, reporting requirements**

See chart attached comparing the principal forms of commercial company.

- **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 profession (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:

- There is no general requirement for any of the managing directors to reside in France or to be a French citizen.
- 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 have to be registered with the municipal authority of their place of residence in France.
- All local managing directors, whether resident in France or abroad, must provide affidavits of parentage and non-conviction and file them with the Registry of Commerce and Companies.

- **Minority shareholders' rights and protection**

  Minority shareholders may have specific protection rights negotiated in the articles of association (*statuts*) 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 in order 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 if this disagreement paralyzes the functioning 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 French Commercial Code).
- Some decisions require the unanimous agreement of all of the shareholders (e.g., any decision which increases the current commitments of a shareholder, change of the nationality of a company).

- **Duty to declare the "ultimate beneficial owner(s)"**

  Every legal entity registered in France has an obligation to declare its "ultimate beneficial owner(s)" to the companies' registry. The French legal entity has to declare the identity of any natural persons who (i) holds directly or indirectly more than 25% of the share capital or the voting rights of the company, or (ii) exercises control, by any other means, over the company. An amended declaration should be filed within 30 days of any fact or event which results in a modification or addition to such information. Only authorized persons may have access to this information.

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

- **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, etc.). 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.

- **Any capitalization 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.

- **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.

(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 interests;
- activities carried out in the field of weapons research, production, or trade of weapons;
- research and development activities relating to cybersecurity, artificial intelligence;
- biotechnology field;
- data hosting activities whose compromise or disclosure is likely to interfere with the performance of certain activities…

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 transaction and obtain its prior authorization.

Once the formal request for authorization is submitted, the Minister for the Economy has two months to respond to the request. If

the Minister does not respond within the time limit, the authorization is deemed to have been tacitly granted.

- **Any restrictions on remitting funds out of the jurisdictions (withholding taxes, 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 taxation 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. The rate of this tax depends on the type of the beneficiary and the time of payment:

  - If the foreign beneficiary is an individual: 12.8% for dividends paid from 1st January 2018 (unless it is proven that the foreign beneficiary is the real beneficiary and that this share distribution hasn't been set up to avoid taxation, in which case a more favorable taxation rate will apply) ;

  - If the foreign beneficiary is a legal entity (as of 2020, the applicable rate will be adjusted in order to match the French corporate tax rate):

    * dividends paid from 1st January 2020 to 31st December 2020: 28%

    * dividends paid from 1st January 2021 to 31st December 2021: 26.5%

    * dividends paid from 1st January 2022: 25%

  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 more than 10% of the share capital of the French distributing company for at least two years preceding the distribution.

  The rate of such withholding tax increases to 75% if the dividends are paid to a non-resident located in a non-cooperative tax jurisdiction.

- 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 tax jurisdiction, 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 tax jurisdiction, a 75% withholding tax applies.

- **Obligation to register a transient branch**

  A transient branch must be registered with the local Registry of Commerce and Companies ("*registre du commerce et des sociétés*") in order to allow employees to work within it. This registration must be done even if the transient branch is open only for a few months.

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

	SA	SARL	SAS	FRENCH BRANCH
GENERAL ISSUES / INCORPORATION				
Number of shareholders	• at least 2 • corporate entities or individuals	• at least 1 and no more than 100 • corporate entities or individuals	• at least 1 • corporate entities or individuals	N/A
Minimum share capital	• € 37,000 • at least 1/2 paid up	• no minimum • at least 1/5th paid up	• no minimum • at least 1/2 paid up	
Shares	• registered shares (*actions nominatives*)	• membership shares (*parts sociales)*	• registered shares (*actions nominatives*)	
Nature of contributions	• cash or contributions in kind	• cash, contributions in kind or performance of professional services	• cash or contributions in kind or performance of professional services	
Payment of contributions	• contributions in kind: fully paid-up upon incorporation • cash contributions: at least 1/2 paid-up on incorporation and remainder within five years	• contributions in kind: fully paid-up upon incorporation • cash contributions: at least 1/5th paid up on subscription and remainder within five years.	• contributions in kind: fully paid-up upon incorporation • cash contributions: at least 1/2 paid-up on incorporation and remainder within five years	
MANAGEMENT				
Management	<u>SA with a board of directors</u> • 3-18 *administrateurs (*directors*)*: - individuals or corporate bodies <u>SA with a management board and a supervisory board</u> • management board: 2-5 members, 7 if the company is listed; • several directors possible or 1 only if capital < 150,000 euros; • supervisory board: 3-18 members (the articles of association may require them to be shareholders)	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. The SARL is managed by one or more individuals (the "*gérants*") who may (but need not) be shareholders. There is no board of directors as such.	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. The only compulsory requirement is that a *président* (equivalent of a CEO) must be appointed. This *président* may be an individual or a legal entity (in this case, it is represented by the legal representative of such entity).	The shareholder(s) is/are free to appoint a representative of the branch.

Responsibility for management	<u>SA with a board of directors</u> • directors can choose between: - a *président* to assume all management powers and chair the board of directors, or - a managing director *(directeur général)* to assume all management powers and a *chairman of the board* with a representative, organisational and supervisory role • the managing director can request the appointment of 2-5 deputy managing directors (*directeurs généraux délégués)* by the board of directors to assist him	• *gérant(s)*	• *président*, in the absence of provision to the contrary in the articles of association	• The representative of the branch is appointed by the foreign company. His/her authority, revocation of that authority, remuneration and liability to the company are therefore governed by the law applicable to the foreign company.
Appointment of managers	<u>SA with a board of directors</u> • directors*:* the first directors are appointed in the articles of association constituting the company; then by the shareholders • chairman of the board: by the board • managing director: by the board <u>SA with a management board and a supervisory board</u> • members of the management board are appointed by the supervisory board (including the president of the management board and, as the case may be, the managing directors); • members of supervisory board are appointed by the shareholders	• first *gérant*: constitutive articles of association or by subsequent shareholders' meeting • subsequent *gérants*: by shareholders' meetings	• procedure freely set by the articles of association	

Removal of managers	SA with a board of directors • directors: by shareholders' meeting • chairman of the board: by the board SA with a management board and a supervisory board • members of the management board are removed by the shareholders or, if the articles of association allow it, by the supervisory board; • members of the supervisory board are removed by the shareholders	• by shareholders' meetings If the sole shareholder dismisses the *gérant* without lawful cause, the *gérant* can file a claim for damages. Lawful cause does not necessarily require mismanagement by the *gérant*; for example, loss of confidence in the *gérant*, significant variance in points of view *vis-à-vis* the management of the company, etc. may be considered as lawful cause.	• procedure freely set by the articles of association	
Powers	SA with a board of directors • *managing directors* are fully empowered to act on behalf of the company and may bind the company by action beyond the company's objects • articles of association may impose limits which are not enforceable against third parties SA with a management board and a supervisory board • members of the management board have extensive powers to act on behalf of the company within the company's objects • members of the supervisory board exercise permanent control and oversight of the management	• *gérant* is fully empowered to act on behalf of the company and may bind the company by action beyond the company's objects • *articles of association* may impose limits which are not enforceable against third parties •	• 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 • A managing director (*directeur général*) 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. • *articles of association* may impose limits on the powers of the President and/or managing director(s) which are not enforceable against third parties	
Liability	• possible tort and criminal liability for breach of legal provisions of the articles of association or of the duty of care towards the company • specific sanctions under bankruptcy law if the company becomes insolvent	• possible tort and criminal liability for breach of legal provisions of the articles of association or of the duty of care towards the company • specific sanctions under bankruptcy law if the company becomes insolvent	• possible tort and criminal liability for breach of legal provisions of the articles of association or of the duty of care towards the company • specific sanctions under bankruptcy law if the company becomes insolvent	

Regulated agreements	• agreements between the company and, directly or indirectly, ➢ one of its directors or its managing director(s), or ➢ one of its "*directeurs généraux délégués",* or ➢ one of its shareholders holding more than 10% of the voting rights or if the shareholder is a company, its controlling shareholder, require prior authorisation by the board of directors, a special auditor's report, and retroactive approval by shareholders' annual general meeting • agreements entered into in the normal course of business and under normal conditions do not require any prior approval; the chairman of the *board of directors* must be notified of such agreements and provide a list of such agreements to the *board* and auditors; except for agreements which, because of their amount or their purpose, are not significant for either of the parties • 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. • The board of directors or the supervisory board may grant a global and annual authorization with no limit on the amount to guarantee the undertakings of its subsidiaries.	• agreements between the company and, directly or indirectly, ➢ a *gérant* or ➢ a shareholder require approval by shareholders' meeting following a report by the *gérant* or the statutory auditor (if any) • if there is no statutory auditor and if the *gérant* is not also a shareholder, agreements between the company and this *gérant* require the prior authorisation of the shareholders • agreements entered into in the normal course of business and under normal conditions do not require any prior approval; • a *gérant* 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 *gérant* or the shareholder is a legal entity.	• agreements between the company and, directly or indirectly, ➢ the president or ➢ one member of any management body (if any) having managing powers, or ➢ one of its shareholders holding more than 10% of the voting rights, or if the shareholder is a company, its controlling shareholder, require retroactive approval by the shareholders' annual general meeting following a report by the statutory auditor (if any) or the president • agreements entered into in the normal course of business and under normal conditions do not require any prior or retroactive approval; • In case of a sole shareholder, such agreements are only mentioned in the registry of the minutes of the sole shareholder of the company. • 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. Articles of association may impose a stricter procedure	N/A

	• The directors or members of the supervisory board, directly or indirectly involved in a regulated agreement subject to a control procedure, may not take part in the deliberations or vote of the board on the authorization requested			
STATUS OF SHAREHOLDERS				
Liability	Limited to number of contributions	Limited to number of contributions	Limited to number of contributions	N/A
Proof of ownership	Shareholders' accounts and share transfer register	Articles of association	Shareholders' accounts and share transfer register	N/A
Participation in decisions	Participate in meetings	Participate in meetings	Participate in meetings	N/A
Rights to information	• at any time may request (*inter alia*): - annual accounts - performance figures for the last 3 financial years - articles of association - list of members of the management bodies and auditors • must receive the formal documents before the ordinary general meeting to approve the accounts (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	• at any time may request (*inter alia*): - annual accounts - performance figures for the last 3 financial years - articles of association - list of *gérants* and auditors (if any) • 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 *gérant* must answer	Freely set by the articles of association	N/A

COLLECTIVE DECISION-MAKING				
Procedure	• general meetings and videoconference • possible vote by post or by proxy	• general meetings or written resolution or videoconference • meetings are necessary: - to approve annual accounts - if requested by several shareholders • possible vote by post or by proxy	• general meetings, written resolutions, or visio-conference voting procedure freely set by the articles of association	• N/A
ORDINARY GENERAL MEETINGS				
Scope of competence	• approval of accounts (meeting must be held at least annually for this purpose) • appointments and changes in membership of the management bodies and auditors • approval of regulated agreements	• approval of accounts (annual meeting must be held for this purpose) • appointment and removal of *gérants* • appointment of auditors	• procedure freely set by the *articles of association*	• N/A
Passing of resolutions	• majority of shareholders in attendance or represented	• simple majority of the shares • articles of association may provide for higher majority (unanimity is prohibited for dismissal of a *gérant* who is also a shareholder) • resolutions which are approved without following the majority requirements may be cancelled at the request of any interested party	• procedure freely set by the *articles of association*	• N/A
EXTRAORDINARY GENERAL MEETINGS				
Scope of competence	• decisions requiring amendment of articles of association	• decisions requiring amendment of *articles of association*	• procedure freely set by the articles of association	• N/A

Passing of resolution	• two-thirds majority of shareholders in attendance or represented	• three-quarters majority of the shares for most resolutions • higher majority for certain specific resolutions • resolutions which are approved without following the majority requirements may be cancelled at the request of any interested party	• procedure freely set by the articles of association although certain decisions require a unanimous vote, for example, decisions increasing the shareholder's liabilities, the modification or deletion of the clause requiring prior approval of a share transfer…	• N/A
DECISION MAKING IF SINGLE SHAREHOLDER				
Scope of competence	N/A	Collective decisions of the shareholders are replaced by the decision of the sole shareholder. The sole shareholder alone has to make the following decisions: - approval of the accounts and allocation of the profits, - appointment of the statutory auditors (if required; see more details below), - appointment and removal of the manager, - 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), - winding-up of the Company.	Collective decisions of the shareholders are replaced by the decision of the sole shareholder. The sole shareholder alone has to make the following decisions: - approval of the accounts and allocation of the profits, - appointment of the statutory auditors, - appointment and revocation of the *president*, - 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), - winding-up of the Company.	N/A

SHARE TRANSFER				
Restrictions on share transfer	• freely transferable unless otherwise provided by the articles of association	• freely transferable to other shareholders unless otherwise provided by the articles of association • 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)	• procedure freely set by the *articles of association* • shareholders may opt for a lock-up clause (maximum ten years), pre-emption clause or squeeze-out clause • those clauses require the unanimity of shareholders	N/A
Formal requirements	Share transfer order and recording in share transfer register	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. Exemption from registration of certain acts entered into since 1st January 2021 (capital increase in cash or by incorporation of profits, reserves or provisions, amortization, or capital reduction)	Share transfer order and recording in share transfer register	N/A
Stamp duty	0.1% proportional fee on the transfer price, payable by the purchaser, with a minimum fee of 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 on the transfer price, payable by the purchaser, with a minimum fee of 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

ACCOUNTING AND FINANCIAL INFORMATION				
Accounting and financial information	• balance sheet, profit and loss account and annex • management report	• balance sheet, profit and loss account and annex • management report	• balance sheet, profit and loss account and annex • management report	• 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, • The filed documents must be translated into French and certified by the depositors
Losses	• net equity cannot be less than half the value of the share capital	• net equity cannot be less than half the value of the share capital	• net equity cannot be less than half the value of the share capital	N/A
STATUTORY AUDITORS				
Statutory auditor	**General harmonized thresholds for commercial companies** A statutory auditor must be appointed if at least two of the following thresholds are exceeded at the end of the financial year: - total balance sheet of at least €4,000,000 - net turnover of at least €8,000,000 - at least 50 employees In corporate groups, each subsidiary that individually exceeds the above thresholds is also required to appoint a statutory auditor. **"Small Groups" (i.e., whose parent company is not required to prepare consolidated financial statements):** • A parent company controlling a Small Group that exceeds, as a whole, the above thresholds must appoint a statutory auditor; unless if this parent company is itself controlled by a company that has appointed a statutory auditor. • Subsidiaries of Small Groups are also required to appoint a statutory auditor if at least two of the following thresholds are exceeded at the end of the financial year ("**Significant Subsidiaries**"): o total balance sheet of at least €2,000,000 o net turnover of at least €4,000,000 o at least 25 employees A company that appoints an auditor (i) on a voluntary or (ii) on a mandatory basis in the case of Significant Subsidiaries of Small Groups, may decide that the auditor will carry out the specific legal audit for small businesses (its tasks and duration of office will be limited). In all cases where a statutory auditor must be appointed and if it is a natural person or a single shareholder company, a deputy statutory auditor is also required.			N/A

Appointment	• first appointment by articles of association for a 6-year term • subsequent appointments by ordinary general meeting for renewable 6-year terms • the term of office of a statutory auditor appointed to carry out a specific legal audit for small businesses is 3 years • the term of office of a statutory auditor appointed on a voluntary basis may be 3 or 6 years • if deputy auditor is required, it must be appointed to replace principal auditor in event of death or incapacity	• appointed by ordinary shareholders' meeting for a 6-year term • the term of office of a statutory auditor appointed to carry out a specific legal audit for small businesses is 3 years • the term of office of a statutory auditor appointed on a voluntary basis may be 3 or 6 years • if deputy auditor is required, it must be appointed to replace principal auditor in event of death or incapacity	• first appointment by articles of association for a 6-year term • subsequent appointments by ordinary general meeting for renewable 6-year terms • the term of office of a statutory auditor appointed to carry out a specific legal audit for small businesses is 3 years • the term of office of a statutory auditor appointed on a voluntary basis may be 3 or 6 years • if deputy auditor is required, it must be appointed to replace principal auditor in event of death or incapacity	N/A
Role	Certifies accounts	Certifies accounts	Certifies accounts	N/A

Fall 21

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ESTABLISHING A BUSINESS ENTITY IN GERMANY

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN GERMANY

Anyone can establish a business in Germany - irrespective of citizenship, nationality, or place of residence. There is no specific investment legislation for foreign entrepreneurs.

Any entrepreneur can make his choice from an exclusive group of different types of legal entities to establish a new company in Germany.

I. Types of Legal Entities

Entrepreneurs can establish a business by either opting for a corporation or a partnership or conducting business via a Germany-based branch office.

The choice of legal form is generally based on the intended role and function of the shareholders, their liability, and terms of taxation.

The legal structure of all company forms is stipulated by law which provides for predictability and legal certainty.

1. Corporations

When choosing the legal form of the company, a corporation is usually the preferred choice for established companies. There are four major forms of corporations under German law:

- Limited Liability Company (GmbH)
- Limited Liability Entrepreneurial Company ("Mini GmbH")
- Stock Corporation (AG)
- Partnership Limited by Shares (KGaA)

A corporation is a legal entity with its own statutory rights and obligations, i.e., the holder of such rights and obligations is not the individual shareholder, but the legal entity itself. Consequently, the corporation itself concludes contracts, holds assets and is liable for taxation.

Liability of a corporation is limited to the corporation's business assets, including its share capital. A minimum share capital is required.

a. Establishment of a Corporation

A corporation can be established by any number of different partners. The share capital can be contributed in cash or in kind (e.g., real estate, office furniture or patents). The deed of incorporation which essentially includes the articles of association must be recorded by a notary. Additional establishment steps are necessary for certain forms of corporations.

The establishment procedure ends with registration in the commercial register held with the local court (Handelsregister). The corporation's limitation of liability only becomes effective upon entry in the commercial register. The application for the registration of the corporation in the commercial register has to be signed by the managing director(s) personally before a notary, who certifies and files it with the responsible commercial register in electronic form. Prior to the corporation starting business, the trade office (Gewerbe-/Ordnungsamt) must be notified of the respective business activity of the new corporation.

b. Taxation of Corporations and its Foreign Shareholders

A corporation resident for tax purposes in Germany is subject to corporate income tax and solidarity surcharge (in total 16.825 %) as well as to trade tax. Trade tax is calculated based on a multiplier, which is assessed by the local authorities. The tax rate currently amounts to 16.1 % of the profit in Frankfurt and to 17.15 % in Munich. However, the actual trade tax burden might be increased by certain restrictions with regard to the deduction of

expenses. Inter alia interest and rental expenses are not fully deductible for trade tax purposes.

Dividends: A shareholder who is a foreign tax resident is subject to limited tax liability with regard to dividends from the German entity. A dividend triggers withholding tax plus solidarity surcharge in the aggregate amount of currently 26.375 %. However, there are certain tax reliefs according to which the foreign shareholder may claim a refund of the withholding tax or an exemption from the withholding (the latter with the consequence that the German company does not withhold any tax on the dividend). This applies to dividends received by a foreign corporation which is a resident of a member state of the EU and holds at least a 10 % stake. If the shareholder is not a resident of the EU, but subject to a double taxation treaty, the tax reliefs provided for in the treaty apply. Most double taxation treaties limit withholding tax on dividends to 5 % if the shareholder is a corporation and holds at least 25.0 % and to 15 % in all other cases. The foreign shareholder may apply for a refund or an exemption from the withholding to the extent that the German withholding tax exceeds the limit under the double taxation treaty.

The German Income Tax Act provides for anti-treaty-shopping-rules according to which the tax reliefs are subject to certain substance requirements to be met by the foreign shareholder. A pure shell company does not meet such substance requirement. According to a judgement of the European Court of Justice, the German anti-treaty-shopping-rules violate EU law. However, according to the German Federal Ministry of Finance, the anti-treaty-shopping-rules are still applicable to shareholders in countries outside the EU (which is controversially discussed). In EU cases, the German tax authorities still apply some of the substance rules (which is also controversially discussed). The legal situation is generally unclear. It is recommendable to consider in each individual case which substance requirements should be met.

Capital gains: If the foreign shareholder holds at least one percent in the German entity, a capital gain is subject to German corporate income tax (if the shareholder is a corporation) or income tax (if the shareholder is an individual). The EU does not provide a tax relief for capital gains. However, according to almost all double taxation treaties concluded by Germany, a capital gain realized by a foreign shareholder with regard to shares in a corporation having its tax residence in Germany is tax-exempt in Germany. If the foreign shareholder is not subject to a double taxation treaty, tax exemptions under German tax law may apply.

Interest on shareholder loans: Interest income from shareholder loans paid by the German entity to its shareholder is generally not subject to taxation in Germany. Especially, no withholding tax accrues. According to the former thin-capitalization-rule, interest on shareholder loans had been subject to reclassification into a dividend with the consequence that such reclassified interest was not tax-deductible and subject to withholding tax. However, the thin-capitalization-rule has been abolished and replaced by the interest barrier (Zinsschranke)), which limits the deduction of interest expenses to 30 % of the taxable EBITDA. The interest barrier only applies if the aggregate net interest expenses of a fiscal year amount to at least EUR 3.0 m. Up to this threshold interest on loans (including loans from foreign shareholders) is fully deductible for tax purposes to the extent that they comply with arms' length principles.

Debt push down: If a foreign investor wants to acquire an already existing German enterprise, the interposition of a German acquisition vehicle in the legal form of a corporation enables to setup a debt push down. This means that the non-capitalized expenses resulting from the transaction – including interest on acquisition loans – can be offset with the operative income of the target company.

c. Limited Liability Company (GmbH)

aa. Characteristics

The German limited liability company (Gesellschaft mit beschränkter Haftung, GmbH) is the "smaller" version of the capital corporation and the most widely used legal form for corporations in Germany. It combines high flexibility with relatively few statutory obligations.

Setting up a GmbH is uncomplicated and can be accomplished within a short period of time.

bb. Share Capital

The minimum share capital required to establish a GmbH is EUR 25,000 (this can be made up of contributions in kind). At the time of registration, at least half of the minimum capital (i.e., EUR 12,500) must be actually and verifiably contributed on a bank account.

cc. Formation Procedure

The formation procedure of a GmbH is fairly uncomplicated, as it is established by the founding shareholder(s) executing a deed of formation and articles of association before a notary public qualified in Germany (Notar).

Ideally, the time period required for the formation of a GmbH is up to four weeks. The estimated court and notary costs for the formation of a standard GmbH are approximately EUR 800 plus the fees for legal counsel.

dd. Management

A GmbH is managed and legally represented by its managing directors. There must be at least one managing director (who does not have to be a shareholder or a German resident). By issuing binding instructions or directions to the managing directors, the shareholders may exercise direct influence on the management of the GmbH.

ee. Registration

In order to be valid, the GmbH must be entered into the commercial register (Handelsregister). All managing directors (Geschäftsführer) must sign the commercial register application in person in the presence of a notary.

Once registered in the commercial register, the GmbH becomes a legal entity. The GmbH must then be registered at the local trade office (Gewerbe- oder Ordnungsamt).

a) "Mini GmbH" (Limited Liability Entrepreneurial Company)

The Mini-GmbH (Unternehmergesellschaft UG, haftungsbeschränkt) is not a separate legal form of company, but a GmbH which has a minimum capital of less than EUR 25,000 and where cash subscription is required. This means that it is possible to set up a company with limited liability in Germany with capital of only EUR 1.00. However, it must be noted that a Mini-GmbH with such an absolute minimum of share capital will hardly be regarded as a serious business partner in Germany and should only be considered as an ultimate start-up model to be capitalized further as soon as possible.

In order to compensate the initial absence of capital the Mini-GmbH has to retain a quarter of its annual profit until it has accumulated the minimum shareholder capital of an ordinary GmbH (which is EUR 25,000). The accumulated capital can then be converted into share capital

and the Mini-GmbH altered into a standard GmbH.

For uncomplicated standardized formation of a Mini-GmbH model articles are provided. These articles must still be notarized, but for a reduced fee. Thus, establishment costs for a Mini-GmbH are reduced to a total of around EUR 300 plus the fees for legal counsel.

Except for the above-mentioned specific provisions, the Mini-GmbH - by terms of law - is generally subject to the same duties and rights as the standard GmbH.

b) Stock Corporation (AG)

aa. Characteristics

A stock corporation (Aktiengesellschaft, AG) is the "larger" version of a capital corporation which can also be publicly listed. The AG generally enjoys a high market reputation among business partners. However, the founding formalities and costs of an AG and the ongoing annual costs for audit, tax filings and reporting are considerably higher than for the GmbH. Also, the AG is subject to extensive organizational obligations in day-to-day business. The AG is liable to corporate income tax, solidarity surcharge and trade tax.

bb. Formation Requirements

In principle, an AG can be established by any individual. Generally speaking, there are only two founding obligations to be observed. First, an AG must have a minimum share capital of EUR 50,000 (which must be fully subscribed by the founding shareholders), and articles of association need to be certified by a notary. Given the more complex statutory obligations, comprehensive legal consultation is strongly advised for drawing up the articles of association and the entire legal set-up of an AG.

cc. Appointing the Management

The founding shareholders appoint the first auditor (Abschlussprüfer) and supervisory board (Aufsichtsrat), which in turn appoints the first management board (Vorstand). The appointment of the first auditor and supervisory board must be notarized.

The founding shareholders must also prepare a formation report with the relevant details of the establishment of the AG. This report has to be scrutinized by the boards.

The AG is managed by its management board. Neither supervisory board nor shareholders can exercise direct influence on the management board.

dd. Registration

The AG comes into existence upon registration in the commercial register (Handelsregister). The application must be signed by the founding shareholders, the members of the supervisory board and the management board before a notary. In addition, an AG must be registered with the local trade office (Gewerbe- oder Ordnungsamt).

c) Partnership Limited by Shares (KGaA)

ee. Characteristics

The partnership limited by shares (Kommanditgesellschaft auf Aktien, KGaA) combines the structures of a stock corporation (AG) and a limited partnership (Kommanditgesellschaft). It connects the entrepreneurial commitment and personal standing of the individually liable shareholders (general partners) with the function of the AG as a public company and source of capital. The KGaA can be described as a stock corporation having individually liable shareholders (general partners) instead of a management board.

The KGaA is not a frequently used legal form in Germany. It is liable to corporate income tax, solidarity surcharge and trade tax.

ff. Liability of Partners

The KGaA can have an unlimited number of capital investors (limited shareholders), whose liability is limited once they have paid their subscribed capital contribution. The minimum share capital of a KGaA is (in total) EUR 50,000. The limited shareholders have more or less the same legal rights as shareholders in an AG. At least one partner of the KGaA, the general partner, has to be liable for debts and liabilities of the KGaA without limitation.

gg. Registration

The KGaA must be entered into the commercial register and registered with the local trade office.

2. Partnerships

The main feature of a partnership is the personal commitment of the partners to their working efforts to the partnership. Any partnership requires at least two partners. There are four major forms of partnerships in Germany.

- Civil Law Partnership (GbR)
- General Commercial Partnership (oHG)
- Limited Partnership (KG)
- GmbH & Co. KG

Their main difference lies in the liability of their partners and required registration obligations.

A partnership company (Partnerschaftsgesellschaft or PartG) is a form of partnership specifically designed for the joint exercising of professional freelance activities, such as architects.

a. Main Characteristics

In contrast to corporations, partnerships are not independent legal entities but associations of people. In partnerships, the individual partners responsible for the liabilities of the company (including private assets) act for the company. Limitations of liability for individual partners are only possible to a limited extent.

No minimum share capital is required, and the accounting obligations and publication requirements are less extensive than those for corporations.

b. Establishment of a Partnership

Establishing a partnership is easy and can be completed in just a few steps. At least two partners are required to establish a company. A minimum share capital does not have to be raised. The management of the company can only be carried out by partners.

Depending on the type of partnership, entry in the commercial register (Handelsregister) is required. The application is signed by all partners and must be filed by a German notary in certified and electronic form with the commercial register. If a business activity is carried out by the partnership, the trade office (Gewerbe-/Ordnungsamt) must accordingly be notified.

c. Taxation of a Partnership and its Foreign Partners

A partnership is transparent for income tax purposes. This means that the partnership is not subject to income tax. Whether the foreign partners are subject to taxation in Germany depends on the circumstances and the structure of the partnership. If the sole business purpose of the partnership is the holding of shares in corporations (GmbH or AG), it is usually possible to structure the partnership in a way that the foreign partners are not subject to taxation in Germany. If the

partnership is, however, engaged in operative activities, the profit realized by the partnership is taxable at the level of the partners in accordance with their participation quota, even if the profit is not distributed to them. If the foreign partner is a corporation, such profit is subject to corporate income tax and solidarity surcharge (in total 16.825 %) in Germany. If the partner is an individual, the profit is subject to income tax at his personal income tax rate, which depends on the amount of income. Income received by an individual is taxed at 44.31 % to the extent that it exceeds approx. EUR 55,000 and at 47.475 % to the extent that it exceeds approx. EUR 260,000.

The transparency principle does not apply to trade tax. Therefore, most of the partnerships are subject to trade tax. The tax rate corresponds to the rate, which applies to corporations (see above). The same applies to restrictions with regard to the deduction of expenses (e.g., interest and rental expenses). If the foreign partner is an individual, a portion of the trade tax corresponding to his participation in the partnership may be credited (in whole or in part) against the partner's income tax liability. Only pure asset managing partnerships can usually be structured in a way so that they are not subject to trade tax.

Interest income from a loan granted by a partner to its partnership is subject to taxation in Germany. This applies even if a double taxation treaty is in place subject to the proviso that the foreign partner may credit his foreign tax against his German income tax liability. Only pure asset managing partnerships can usually be structured in a way so that such interest income is not taxable in Germany.

d. Civil Law Partnership (GbR)

A civil law partnership (Gesellschaft bürgerlichen Rechts, GbR) is defined as an association of individuals or enterprises united in the achievement of a joint contractual purpose. It is suitable for start-ups launching a business idea in cooperation with others.

Formation of a GbR is fairly uncomplicated. At least two partners must agree on the establishment of the GbR and conclude a partnership agreement. A written partnership agreement is recommended but is not compulsory. The partners are jointly liable with their private assets for debts incurred by the company. If the GbR conducts trade in the form of a small trade business, it has to register with the local trade office. It must not be entered into the commercial register.

A GbR is only allowed to conduct "small trade business." As soon as it exceeds certain thresholds of annual turnover, capital resources and total number of employees or uses commercial accounting, the company is deemed to be a commercial business and must be entered in the commercial register upon which it automatically becomes a general commercial partnership (Offene Handelsgesellschaft, oHG).

e. General Commercial Partnership (oHG)

The general commercial partnership (Offene Handelsgesellschaft, oHG) is the classic partnership form for small and medium-sized enterprises (SMEs). Its structure corresponds to the civil law partnership (GbR). Every GbR that runs a commercial enterprise (a business enterprise of a type or size requiring business operations to be set up in a commercial manner) automatically qualifies as an oHG. Accounting regulations for an oHG are stricter than those for a GbR.

In order to establish an oHG, two or more partners must conclude a partnership agreement. It is advisable for the partnership agreement to be made in writing. All partners

are jointly and severally liable for the oHG's debts and liabilities.

The oHG must be entered in the commercial register and registered with the local trade office. The application to the commercial register must be made by all partners and be certified and filed by a notary. The expenses for registration vary but are about EUR 400. Fees for legal counsel are not included.

f. Limited Partnership (KG)

The limited partnership (Kommanditgesellschaft, KG) is a legal form related to the oHG, but with the option of limiting the liability of some of the partners. This legal form is suitable for medium-sized enterprises (SMEs) seeking additional start-up capital but wishing to limit individual responsibility.

At least one partner, the general partner (Komplementär), is personally liable without limitation. The liability of the limited partners (Kommanditisten) is limited to their respective share of the partnership capital. A KG offers greater flexibility compared to other forms of partnerships as the capital base can be increased by including additional limited partners.

A KG is established when a partnership agreement between two or more partners (including at least one limited and one unlimited partner) is concluded. It is advisable for the partnership agreement to be made in writing. The liability of the limited partner will only become limited once the registration of the KG and the subscribed partnership contribution has been entered in the commercial register (which is obligatory).

The application to the commercial register must be made by all partners and be certified and filed by a notary. The costs for registration vary but are about EUR 400. A KG must then be registered with the local trade office. Fees for legal counsel are not included.

g. GmbH & Co. KG

The GmbH & Co.KG is a limited partnership (KG) in which the general partner (Komplementär) is a limited liability company (GmbH). The GmbH is fully liable for the GmbH & Co. KG's debts and liabilities. The liability of the limited partners (Kommanditisten) is limited to their respective share of the partnership capital.

This hybrid form is suitable for entrepreneurs wishing to limit their liability while enjoying the flexibility of a non-incorporated business. Because of its flexibility, the legal form GmbH & Co. KG is especially appropriate for medium-sized businesses and family companies.

The GmbH & Co. KG is established through conclusion of a partnership agreement between the general partner and the limited partners (advisably in writing). Typically, the shareholders of the general partner (GmbH) are identical to the limited partners of the KG.

In line with the registration formalities of the KG, the GmbH & Co KG must be entered in the commercial register and registered with the local trade office. The liability of the limited partner will become limited once the KG and the subscribed partnership contribution are registered in the commercial register.

The application to the commercial register must be made by all partners and be certified and submitted by a notary. The costs for registration in the commercial register vary but are about EUR 400. Fees for legal counsel are not included.

h. Branch Offices

Any foreign company with a head office and registered business operations outside of Germany can establish a German branch office. A branch office is a suitable business form for a

foreign company wanting to establish a presence in Germany for the purpose of initiating business and maintaining contacts with business partners.

In Germany, there are two kinds of branch establishments which primarily differ due to the degree of the independence from the head office company:

- Autonomous Branch Office
- Dependent Branch Office

aa. Main Characteristics

A branch office has no independent or separate legal personality distinct from the head office itself. In legal and organizational terms, it is part of the head office business and is thus subject to the law governing the head office. In this context, the foreign head office company is fully liable to the extent of its own assets for any claim's creditors might assert against the branch office. Any obligations or debts incurred by the branch office are also legal responsibility of the foreign company.

bb. Taxation of Branch Offices

A branch office is subject to taxation in Germany if it is considered as a permanent establishment according to the applicable double taxation agreement (DTA). An autonomous branch office is generally regarded as a permanent establishment, whereas a dependent branch office is only considered a permanent establishment under certain conditions.

A German permanent establishment of a foreign corporation is taxed in Germany according to German taxation rules for corporations (corporate income tax, solidarity surcharge and municipal trade tax).

(i) Autonomous Branch Office

- **Characteristics**

The autonomous branch office (selbständige Zweigniederlassung) fulfills tasks that exceed mere implementation and support-related tasks. It is dependent upon the head office company at the internal level but engages in business activities independently. However, the foreign head office company is liable for the business transactions concluded by the branch.

At the organizational level, autonomous branch offices are to a certain extent independent from the parent company and usually have the following attributes:

- Management with freedom to act according to their own judgement (i.e., with full power of attorney and power to contract)
- Own capital resources and bank account
- Separate accounting

An autonomous branch office can use its own name affix (for example: XY Ltd., branch office, Berlin).

- **Setting Up an Autonomous Branch Office**

Foreign companies can set up an autonomous branch office in Germany if they are entered in a foreign commercial register (or a comparable directory).

The decision to establish a branch office must be made by the managing directors of the head office. The autonomous branch office must be entered in the commercial register and registered with the local trade office.

- **Registration in the Commercial Register**

The application for registration in the commercial register must include detailed information on the foreign company and generally be accompanied by a notarized copy

of an excerpt of the commercial register showing the existence of the foreign company and the power of representation of the managing director(s) and the management board as well as from memorandum and articles of association. All documents should be in German certified translation and the notary's certificate must be authenticated.

- **Trade Office Registration**

The autonomous branch office must be registered in the trade office before business operations are started. A business license or permit is generally not necessary for registering the business. Only for some business sectors, a permit or authorization may be required. Trade office registration must be submitted on commencement of business at the latest.

(ii) **Dependent Branch Office**

A dependent branch office (unselbständige Zweigniederlassung) is a subordinate department of the head office company and does not have any autonomy from it. It focuses on maintaining contacts and initiating business in Germany.

The dependent branch office is not able to independently participate in the general business transactions of the head office. It performs support and implementation-related tasks without having any individual business discretion and is entirely dependent on the head office.

An individual company name cannot be used.

As a dependent branch office displays no autonomy vis-à-vis the head office of the company, it is not entered in the commercial register. The only formal requirement for a dependent branch office is registration with the local trade office, for which certain documentation on the foreign company is also necessary.

II. Business Registration

1. Entry in the Commercial Register

In the establishment phase of a company - and prior to assumption of commercial activities - a company only has to be registered in the public commercial register (Handelsregister) and the local trade office (Gewerbe-/Ordnungsamt). The registration creates transparency and also offers companies the highest level of security in their day-to-day business activities.

2. Companies Required to Register

Companies required to register are those which carry out a commercial business operation. This is determined by criteria such as the use of commercial accounting, annual turnover, capital resources and total number of employees. As a rule, all status relevant actions of companies are subject to registration.

Small businesses, civil law partnerships (GbRs), freelancers and dependent branch offices do not have to be registered in the commercial register.

3. Registration Procedure

The application for registration in the commercial register is electronically filed in publicly certified form by a notary to the responsible commercial register.

As a rule, with types of company in which the entry in the commercial register is part of the act of establishment, the possible limitation of liability of the partner(s) is only effective subsequent to the time of the entry in the commercial register. If business is carried out prior to this point in time, partners can be liable for any losses of the company with their private assets (especially the case with corporations).

4. Registration Costs

The total cost of entry in the commercial register varies depending on the type of

company. Costs incurred are made up of costs of the notarial certification and the fees charged by the district court for entry and publication in the Federal Gazette (Bundesanzeiger).

The cost for registration and publication in the commercial register for a partnership is currently at least EUR 300. For a GmbH, this amount is at least EUR 400, and for an AG at least EUR 500. Additional costs are incurred for the use of a notary and the fees for legal counsel.

The costs and notary fees are not levied on an arbitrary basis but are regulated by law. They largely depend on the number of partners and the share capital. Fees incurred by legal counsel are agreed separately.

5. **Commercial Register Display**

The commercial register is managed by the local court (Amtsgericht) where it is open to public view at no cost. In addition to this, the register can also be consulted online through the common register portal of the German federal states (Gemeinsames Registerportal der Länder)[17].

Some of the company data which is stored in the commercial register is also available electronically through the commercial register of the Federal Gazette (Bundesanzeiger).

Due to the harmonized EU Law, the documentation effort for European companies is fairly modest. For non-European companies it can be extensive, the exact details depending on the foreign company's residence. The application must be certified and submitted by a notary.

III. **Transferring Assets**

1. **Capital**

Capital can be moved in and out of Germany without any restrictions. However, amounts over EUR 12,500, or equivalent payments with valuables, must be reported to the German Central Bank (Bundesbank). These reports are for statistical purposes only. Forms can be obtained from the Bundesbank.

Reporting obligations for money transfers from abroad depend on the place of residence of the recipient/addresser: nationality is irrelevant. A person or company with a place of residence or business in Germany must report incoming and outgoing payments from abroad for all transactions over EUR 12,500. Alternately, an investor with a place of residence abroad does not have to register a capital transfer to an account in Germany (even if the investor is the account holder).

Payments for the import or export of goods and details in connection with the granting, taking out, or repayment of loans with an originally agreed term of less than twelve months do not have to be reported. For statistical purposes, every person living in Germany and every company located there must also inform the Bundesbank of the ownership of securities or deposit accounts abroad.

Receivables or liabilities from companies (for example, banks) or private individuals abroad must be reported to the Bundesbank if they amount to more than EUR 5 million or equivalent.

For bank account deposits of more than EUR 10,000 cash, banks are required to check the identity of the depositor in order to prevent money laundering.

17 https://www.handelsregister.de/rp_web/welcome.do

2. **Goods and Machinery**

Goods and machinery can circulate freely within the EU. Customs import turnover tax (Einfuhrumsatzsteuer), and in some cases, special excise taxes are charged for imports to Germany from non-EU states. The customs payable can be determined online using the TARIC (Integrated Tariff of the European Communities) system. Customs are not charged on investment goods if business operations have been transferred in full to Germany.

Household objects can also be imported into Germany freely if the owner moves place of residence from abroad to Germany. A customs exemption of this kind must be applied for in writing beforehand.

Fall 21

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 new law 4548/2018, which entered into force on 01.01.2019.

The S.A. 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. The majority 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 has to 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, shipbroking, and agency of ship owning companies or bareboat charterers or ship lessees and any similar services to the above. Moreover, a permit may be granted to maritime/ ship owning/management companies of salvors or tugs. Some additional prerequisites are also mentioned in the law.

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 (consulting; accounting; production quality control; drafting of researches, plans and contracts; advertising and marketing; research and development; software development, computer programming and computer systems support; storage and management of files and information; management of suppliers, customers and supply chain not including transportation by their own means; human resources management and training; call center and computer-based call center information activities).

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, in principle, 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 are 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. It must be noted that according to the previous legal framework, bearer shares were also provided, however, according to the new law 4548/2018, the "bearer shares" were abolished from 01.01.2020. Furthermore, the law 4548/2018 provides the option of issuing also "warrants" and the option of "stapling" more type of instruments issued by the SA (e.g., bonds with warrants).

-The nominal value of each share must be more than €0.04 and less than €100. The shares may have different values (however they have to 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 has to 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). Especially regarding the amendment of the articles of association, the required majority is 1/2 of the number of partners and 65% of the capital.

-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). In principle, 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 (especially regarding the Private Company, it takes place online, unless a real estate property is contributed to the company). The documentation needed (e.g. articles of association, power of attorney to a representative in order 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 has to 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 have to be in the form of a notarial deed). It must be noted that regarding the S.A. and the Ltd, there is no need for a notarial deed, if the articles of association are drafted on a template form provided by the Greek law. In such a case the One-Stop-Shop is the General Commercial Registry.

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

In addition, the law 4441/2016 provides a procedure of electronic establishment of companies (excluding the SA and the Ltd for which a notarial deed is required) with the use of template articles of association.

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 4548/2018 (entered into force on 01.01.2019) 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 S.A.s may also include in their articles of association another body as well, the "Executive Committee" which may authorized to run the day-to-day business and the Board of Directors may be restricted to a supervisory role. The "Executive Committee" can consist of members of the Board of Directors and third parties. Furthermore, the small or very small entities (see below under 3.1.5), which are not listed, may elect instead of a Board of Directors, a single-membered administrative body.

The meetings of the BoD may take place with natural presence or with teleconference.

If an S.A. constitutes a "small" or "very small entity" (see below under 3.1.5), instead of a Board of Directors it may include in its Articles of Association the option to elect a Single-Member Administrative Body, the "Manager-Director", and all the provisions of the law referring to the BoD, apply to the Manager-Director as well.

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 1/2 of the share capital and a majority of the 2/3 of the share capital.

If there is a relevant provision in the articles of association, the General Assembly may decide by "written resolutions" or by the signing of the resolutions by all the shareholders and the "signatures" may take place even by exchange of e-mails. Under some conditions the General Assembly may take place with teleconference.

The General Assembly is convened by the Board of Directors at least once per year, in order 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 has to be registered at the General Commercial Registry.

The S.A. has to 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 on several issues, in order 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 PC is governed by the law 4072/2012.

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 with teleconference), and it is convened at least once per year, in order to approve the financial statements. Subsequently, the decision and the financial statements have to 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 guaranteed 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 has to 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, in order to approve the financial statements and the decision and the financial statements are registered at the General Commercial Registry.

The Ltd has to 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 have to 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).

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)** apply before a court in order to reduce the remuneration of the members of the BoD under several circumstances; **v)** apply to the Board of Directors to file a claim against any member of the Board of Directors regarding the administration of the company's affairs. The BoD is not obliged to act, but it has the right to dismiss the minority's application after it has assessed the interests of the company.

-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 1/10 of the share capital.

-The shareholder(s) with shares representing the 1/3 has the right to apply to the Court for the termination of the company, if there is any 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 1/10 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.

-The permission for transactions with related parties is granted by the BoD, however shareholders with shares representing the 1/20 may demand the convocation of the General Assembly to decide on the subject. Until the convocation of the General Assembly, if such a permission was granted, it is revoked, if there is an opposition of the shareholder(s) with shares representing the 1/20 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 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").

- Each shareholder of an unlisted company may demand information about the amount of the capital, the categories of the issued shares and their number, the rights that each category attributes, if there are any restricted, their numbers and the restrictions. Furthermore, each shareholder has the right to demand information about his/her shares.

- Each shareholder of an unlisted company may demand information about the future General Assemblies to be sent to him by e-mail 10 days before the General Assembly.

- Each shareholder may demand a table of the shareholders (including their names, address, and number of shares), if such a right is attributed by the articles of association.

- The law 4548/2018 includes also provisions about "Unions of Shareholders" that may enforce the minority rights of their members on behalf of them.

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 of all, 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; **iii)** the 1/10 of the capital and simultaneously represent the 1/10 of the number of the partners may apply to the Court in order to revoke the director(s) of the company.

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 excessing 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, 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 €25,000. However, the minimum capital may be higher for several types of undertakings (e.g., banking services) or in order to be listed in the stock exchange market.

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 on the basis of 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. However, the nominal value of each portion of participation cannot be less than €1.

If the total shareholders equity becomes less than the 1/2 of the share capital, the directors have to convene the Assembly in order to take any appropriate measures or else the Court may decide 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.

4.3 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: Indicatively, 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 a 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.

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INTERNATIONAL LAWYERS NETWORK

JALSOVSZKY

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. As a consequence, 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.

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.

Hungarian law also enables the members of a kft. to denominate the registered capital of the respective company in EUR or USD. In such case, the books of the company must also be kept and the annual report must be prepared in the same currency.

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.

3.7 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. 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 for a maximum term of 5 (five) calendar years starting from the date of the appointment.

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. If any of the shareholders provides an in-kind contribution to the registered capital of the respective company, the actual value of such in-kind contribution must be certified in writing by an independent auditor.

Hungarian law also enables the shareholders of a zrt. to denominate the registered capital of the respective company in EUR or USD. In such case, the books of the company must also

be kept and the annual report must be prepared in the same currency.

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 for a maximum term of 5 (five) calendar years starting from the date of the appointment.

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 in the course of 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.

5.4 If a member or an executive officer of a Hungarian company does not have a Hungarian address or registered seat, a delivery agent must be appointed. The delivery agent will receive any official deliveries addressed to the respective member or executive officer by a court or other authority. The delivery agent can be a legal person or a private individual, who has a registered office or residence in Hungary.

If a delivery agent had been appointed, a document containing the authorisation of the delivery agent and the declaration of acceptance must be submitted to the Court of Registry.

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 35: 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, otherwise the procedure can take 15 business day at most.

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 has to take into account 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 until 31 May of each calendar year if the financial year of the respective company is the same as the calendar year, otherwise, within 5 months from the end of the financial year.

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 in order 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

Jalsovszky Law Firm is a leading independent commercial law firm with unrivalled expertise and experience in tax, mergers & acquisitions and corporate finance. We are international in quality and perspective, we are independent in the personal nature of our delivery of legal services and we are local in the sense we understand how things work locally and we can use that to our clients' advantage.

We are a young, but experienced and innovative team of lawyers, combining international standards of ethics with practical local experience, with a clear focus on identifying potential issues and providing real-world solutions.

We work with leading companies and investors, both domestic and regional, across a range of sectors, helping each of them to manage legal, regulatory and tax risk, thus allowing them to optimise their business performance.

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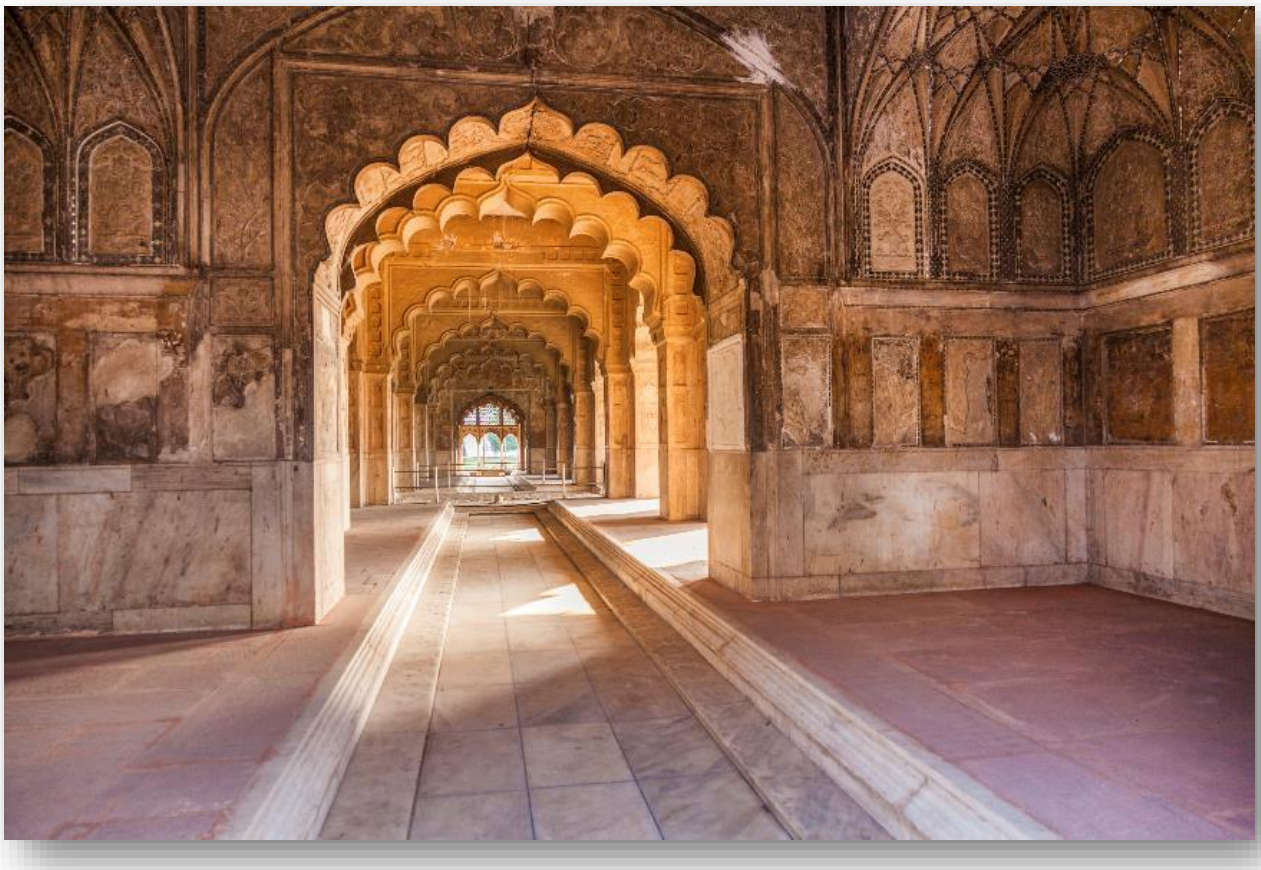
INTERNATIONAL LAWYERS NETWORK



LEXCOUNSEL LAW OFFICES

ESTABLISHING A BUSINESS ENTITY IN INDIA

ILN CORPORATE GROUP

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 (ranging from 25% to 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 or a Limited Liability Partnership (LLP) 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 to obtain a digital signature. Also, persons seeking appointment as directors of an Indian company or designated partners in the case of an LLP are mandatorily required to obtain director identification number ("**DIN**") or Designated Partner Identification Number ("**DPIN**"), respectively. without which such appointment would be invalid. The DIN or DPIN, as the case may be, is specific to each individual and there is no requirement of a fresh DIN or DPIN for appointment as a director of other Indian company(ies) or LLP(s). A company or LLP 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 needs 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 (including a company and an LLP) 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. Declaration of Commencement of Business – Every company is mandatorily required to file a certificate of commencement of business within

180 (One Hundred and Eighty) days from the date of incorporation of the company. There is no such requirement for an LLP.

C. 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 while there is no such requirement for an LLP. It is also mandatory for every company and LLP to have at least 1 (one) resident director or designated partner, respectively.

D. 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.

E. 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 annual return by an LLP, 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-Managerial 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 LLPs as well as 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 and LLP to have at least 1 (one) resident director or designated partner, respectively, i.e., a

person who has stayed in India for a total period of not less than 182 (one hundred and eighty-two) days during the financial year/immediately preceding 1 (one) year, as specified by the law .

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 the 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 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 at 15.00% (fifteen percent) plus 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.

Branch offices of foreign companies can also remit business profits to their principals subject to withholding tax at 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 LLP

ESTABLISHING A BUSINESS ENTITY IN IRELAND

ILN CORPORATE GROUP

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 object's 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.

In addition, with effect from 2019, Irish companies are also generally required to maintain a register of their beneficial owners and to file such details in the CRO. A beneficial owner is any natural person who ultimately owns or controls a legal entity through direct or indirect ownership of 25% or more of shares or voting rights or ownership interests.

Ireland adopted the fifth Anti-money Laundering Directive in March 2021, and it includes new obligations on designated persons to verify the beneficial ownerships of their customers before carrying out business.

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 dispose 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. EGMs 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. During 2020 and 2021 emergency legislation has been in place permitting virtual meetings due to Covid-19.

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% [NOTE: Agreed to rise to 15% by international agreements reached in October 2021] 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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ESTABLISHING A BUSINESS ENTITY IN ISRAEL

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN ISRAEL

Introduction

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. There are private companies, which are companies whose shares cannot be publicly traded and public companies whose shares may be publicly traded on recognized stock exchanges, subject to applicable securities laws. 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 the purpose of 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 the purpose of providing legal or accounting services, general partnerships are limited to a maximum of 20 partners, whereas no similar limitation applies to a company. The partners of general partnerships are jointly and severally liable to third parties for all of 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 a different division between them.

Limited partnerships – consist of 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 partners can enjoy the profits of the partnership, according to their equity share in the partnership.

Limited partners may not participate in the management of the partnership, and they do not have the authority to represent or 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 of time in which they participated 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 simply open up office branches located in Israel, though this requires them to register as a "Foreign Company" with the Israeli Registrar of Companies or “Foreign Partnership” with the Israeli Registrar of Partnerships. The process for registering a foreign company requires:

- a copy of its articles of association or the equivalent document in its jurisdiction, together with a notarized Hebrew translation;
- a certified copy of the company’s certificate of incorporation, which must be apostilled. If the company originates from a country that is not a part of the apostille convention, then it must be verified by the foreign ministry of the originating country and then by the Israeli consulate in that country. If not in English or Hebrew, the certificate of incorporation must be accompanied by a notarized Hebrew or English translation. If the company’s home country does not issue certificates of incorporation, then the company must file as part of its registration application written confirmation of this fact and official confirmation from the country of origin that the company is registered in the country’s register of companies or another official means of proving the existence of the company if the country does not keep a register of companies;
- a certificate of good standing from the originating country translated into Hebrew;
- a certified copy of a power of attorney or letter of authorization that empowers an Israeli resident to act on-behalf of the company in Israel. The document must specify the resident’s full name, address, and Israel I.D. number.
- notice of an Israeli resident that is authorized to receive court notices and pleadings on-behalf of the company, which must provide the person’s full name, address, and ID number;
- a list of directors of the company, including the I.D. numbers of any Israeli director and the passport numbers of the foreign directors;
- details of the citizenships of each director and valid passport photographs for each foreign director.
- Payment of the Registrar’s fee, which currently is the same as the fee for registering an Israeli company (See below) may be made online following which a receipt is provided, and the receipt must be filed with the rest of the documents.

The documents may be filed in person at the offices of the Registrar of Companies, and they may also be filed online by lawyers holding specially approved smart cards for the purposes of making online filings with Governmental institutions. Similar documents are required for the registration of foreign partnerships with the Israeli Registrar of Partnerships, except in so far as they relate to the partnership agreement and identities of the partners, including details of the general partners and limited partners in the case of limited partnerships.

One should note that registration in Israel does not distance the foreign company from its Israeli branch with respect to any obligations entered into or debts taken on by the Israeli

branch, all of which may be claimed against the foreign company as a whole and is not restricted to the Israeli branch.

Additionally, a branch is very likely to fall under the definition of "permanent establishment" for tax purposes, meaning that the branch will be taxed by the Israeli Tax Authorities on the income derived from its Israeli activities and according to Israeli tax laws, meaning it must register with the Israeli tax authorities and file annual Israeli corporate tax returns for the income generated 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 have to 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. While limited partners enjoy protection from liability for the debts and obligations of the partnership, they cannot be involved in the management or representation of the partnership. Therefore, the influence that a limited partner may have on the partnership, even where their capital contribution was considerable, is significantly less than a shareholder may have on a 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 general 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 in order 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 wrongdoing is still required in order 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 2021 is 23%. However, in many cases the company's tax rate serves as a starting point and can then be reduced by using tax benefits available under various other 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 in 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.

Partnerships - 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 50%. 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 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 where 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.

New Insolvency Regime

The Law of Insolvency and Economic Rehabilitation 2018, which came into effect in September 2019, is intended to provide the Israeli with a modern insolvency regime.

The law has three primary objectives:

1. to promote the debtor's economic rehabilitation;
2. to maximize the debt repayment to creditors;
3. to divide the debtor's pool of assets into a more equitable manner between the secured and unsecured creditors;

The key principles of the law are as follows:

A clear and simple definition of insolvency – An entity shall be deemed insolvent if it cannot actively pay its debts. By adopting this new definition of insolvency, the legislator abandoned, de facto, the current balance-sheet test according to which, creditors may not file applications preemptively.

Uniformity in the opening of proceedings – The law seeks to create a uniform and orderly procedure for opening proceedings against a corporation facing insolvency without the legal procedure for handling the insolvency being dictated by the technical manner through which the application was filed.

Creditors' debt repayment order and distribution of funds – According to the law, some of the debt repayments will be carved out from the sums owed to the State and to the strong secured creditors (i.e., banks). They will then be distributed among the general unsecured creditors holding no collateral whatsoever. In the majority of cases, these general creditors (usually suppliers, customers, and employees) receive only a tiny portion, if any, of the debtor's pool of assets. Within this context, the new law prescribes, inter alia, that 25% of the assets pledged under a floating lien (to differentiate from a specific lien on a specific asset) be carved out in favor of the debtor's general unsecured creditors. The new law also reduces the preferential right given to the State (mainly when it comes to debts to the tax authorities) when dividing up the debtor's assets.

Minimizing damages – The law imposes an obligation on the board of directors of the debtor corporation to take all reasonable measures to minimize the extent of the insolvency during the period prior to the opening of insolvency proceedings.

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 for a person to be appointed as a director, they must not be a minor, incompetent or have been declared bankrupt.

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 by reason 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 has 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 of 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 online application form is prescribed by regulations and may be downloaded from the Registrar's website. It is also possible to obtain a special smart card from Comsign confirming the identity of the applicant and providing for a secure and certified electronic signature. Holders of the smart card may complete and file the forms online.

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 sets 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 or in a separate agreement like a shareholder's agreement, 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 (although Companies may issue shares with no nominal value), 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. In addition to Hebrew and Arabic, the articles of association may be filed in a foreign language, provided that: (i) articles filed in English must be accompanied by a Hebrew translation with a certification from the Company as to the accuracy of the translation and that the English version is the governing version; and (ii) articles filed in any other foreign language must be accompanied by a notary certified Hebrew translation.

- Filing of the Declaration of the First Directors of the Company, in which they declare their competence to serve as directors. Only one director is required.
- Payment of the registration fee, the amount of which depends on whether the application is being filed online (NIS2,167) or by a paper application (NIS2,645). At the time of writing, the fee for a paper application is the equivalent of approximately US$785). Companies also have to pay an annual fee to the Registrar of Companies. In 2021 the annual fee is NIS 1,505 or NIS 1,133 if paid by the end of March of that year.

It normally does not take long to establish a new company, with times from filing the documents with the Registrar of Companies being normally 3 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 in order 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 2021 costs a fee to the registrar of NIS 965 (app. US$287). In 2021, the annual fee is NIS 1,500 or 1,129 if paid by the end of March of that year.

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 2,635 (app. US$785) and payment of an annual fee which is the same amount as the annual fee for companies and general partnerships.

It normally does not take long to establish a new partnership, with times from filing the documents to the Registrar of Partnerships being up to 7 business days.

Non-Israeli Company Branch

A non-Israeli company may simply open up 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 in order 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 up a branch in Israel. In order 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 Minster of Justice for approval to be registered in Israel, and the Minister of Justice has sole and absolute discretion to determine whether or not to approve such requests.

The fees payable to the registrar in order 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 have to 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 615,408.73 (as of the time of writing, approximately US$182,184) may vote in a general meeting of shareholders to waive the requirement to appoint an auditor, provided that there are no more than 10% of vote opposing the decision.
- Pay an annual fee (see above for details).
- 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 also have obligations to publish financial reports in the manner set out in the Securities Law 1968. A company must also file with its annual report a balance sheet unless its articles of association contain restrictions on there being more than fifty shareholders, subject to certain exceptions – e.g., shareholders who acquired their shares as employees under an employee share option plan do not need to be counted in the fifty.
- 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 (see above)..
- Notify the Registrar within 14 days of any changes to the information contained in the documents delivered to the Registrar (e.g., addition or removal of partners and changes of name).

Requirements for local shareholders/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, Capitalisation Requirements, Residency and Material Visa Restrictions

Generally, there are no significant barriers to foreign persons or entities setting up Israeli companies, being appointed as directors of Israeli companies or being shareholders of Israeli companies, though restrictions will apply in very limited cases. For example, a company seeking a license to manufacture firearms must not be owned by foreign shareholders.

Any capitalisation obligations

There are no specific capitalisation obligations in terms of minimum capitalisation for either companies or partnerships. Companies may now be formed that do not specify a specific share capital and merely provide for an authorized number of shares of no nominal value.

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 foreigners who wish to work in Israel.

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

Withholding tax is deducted from dividend distributions paid by Israeli companies to their shareholders (see above for more details).

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 see through tax rules that are more closely related to partnerships. Cooperative societies are a form of entity that were 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 in order to run charities and other non-profit initiatives and enterprises, such as the operation of schools and colleges.

Public Benefit Company

This form of corporate entity ("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 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.

Covid-19 Note.

Please note that while various government grants and tax reliefs have been made available for Israeli business entities to assist them to deal with the hardships caused by the novel coronavirus pandemic, due to the constantly changing circumstances surrounding these grants and benefits in light of the changing effects of Covid-19 on the Israeli economy, we did not feel it helpful to provide any details in this guide that could immediately become outdated. However, we will be happy to answer any specific questions we may receive in connection with this.

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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 or domestic investors.

A minimum capitalization of Euro 50.000 (fifty thousand) is 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, 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.

1.2.4 The Simple Investment Company

The Italian "*Simple Investment Company*" (SIS – *Società investimento semplice*) represents a new type of company, introduced by the Law Decree of 30 April

2019 n. 34, so called "*Growth Decree*" (*Decreto Crescita*).

This is a new investment vehicle, aimed at facilitating the raising of capital for Small and Medium Enterprises – SME (*Piccole Medie imprese* - PMI).

The new type of company stands as an innovative Collective Investment Scheme (*OICR – Organismo di Investimento Collettivo del Risparmio*), which according to the provisions of Article 27, paragraph 1 of the "*Growth Decree*", has to be in the form of an Investment Company with fixed capital, which is necessarily a Joint Stock Company (*SPA – Società per Azioni*) and must comply with the following conditions:

(i) The company name has to contain the indication of "*simple investment company for fixed capital shares*";

(ii) The registered office and general management of the company have to be located in the territory of the Italian Republic;

(iii) The recourse to the financial leverage is not permitted. This means that the company must not buy or sell financial assets for an amount greater than the capital held;

(iv) The share capital has to be at least equal to that provided for by article 2327 of the Italian civil code, i.e., at least 50 thousand Euros, notwithstanding the provisions of article 35-bis, paragraph 1, letter c of the Consolidated Law on Financial Intermediation (TUF);

(v) Net worth cannot exceed € 25 million.

Furthermore, the legislator, with a view to guaranteeing functionality and internal stability, and the solvency of the *Simple Investment Company* (SIS); prescribes:

(i) The Mandatory of the conclusion of insurance policy on professional civil liability appropriate to the risks related to the activity carried out;

(ii) That the SIS has an adequate system of governance and control to ensure the safe and prudent management and compliance with the provisions provided.

Thanks to the requirements the SISs must have, they present themselves as a particularly lean investment vehicle with less operational complexity and for this reason, take advantage of some simplification compared to the rest of the companies whose activity consists in raising financial capital.

In fact, the Growth Decree, establishes that the implementing provisions under article 6, paragraphs 1, 2 and 2-bis of the TUF, which contains a whole series of very restrictive and binding obligations in terms of transparency, publicity, and controls by the supervisory bodies (Bank of Italy and CONSOB), do not apply to SIS. This means that an important part of the secondary legislation issued by the Bank of Italy and the CONSOB, to which the Investment Companies are normally subjected, will not be applied to the SISs, with the consequent simplification of their activity and their management.

Further simplification is set in the matter of the requirements pertaining to the subjects who hold a participation in a SIS. In fact, this subject, pursuant to the new art. 35-undecies TUF, must possess exclusively the requisites of honorableness prescribed by art. 14, with the exclusion of the

requirements to demonstrate competence in the financial industry.

Finally, the legislator provided one more limit to the SISs. Subjects that control a SIS directly or indirectly through subsidiaries or parent companies or are subject to common control also by virtue of shareholders' agreements or contractual obligations pursuant to Article n. 2359 of the Italian Civil Code, may constitute a new SIS only within the overall limit of 25 million Euros. A similar limit is also set for subjects who perform administration, management, and control functions in one or more SISs.

The above has been established because, in the opinion of experts, this new type of company could favor the concealment of large investment projects, which with the new legal entity would be fragmented through the "serial" establishment of SISs.

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 coordination of companies is deemed to exist, but it sets forth only a few general rebuttable presumptions of its existence. More precisely, the activity of coordination and direction is presumed to be exercised towards those companies 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 coordination 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 into consideration the most typical effects connected to the relevant phenomenon (i.e., the coordination 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 coordination and direction is lawful so long as it is practised properly. Prior to the Reform, the lawfulness of such practice was highly debated among 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 coordinated 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 coordinated 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 coordination, 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 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 coordination 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 translations of (i) the Foreign Company's incorporation deed and articles of association (in case of an 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. is 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 with 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.

For either of 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, which 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, the 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 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 mentioning 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, and 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 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 of 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 restrictions or barriers are generally provided under Italian Law for offshore business and investments.

Therefore, all the requirements generally provided for both Italian and foreign investments are applicable to offshore parties, such as the compliance of the company's purpose with Italian law provisions, compliance with regulations provided for specific activities such 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 regard 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 double taxation conventions with eighty-four countries, 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 mentioned above do not apply to dividends paid to receivers that are income taxpayers in the 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 an 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 headquarters 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 a 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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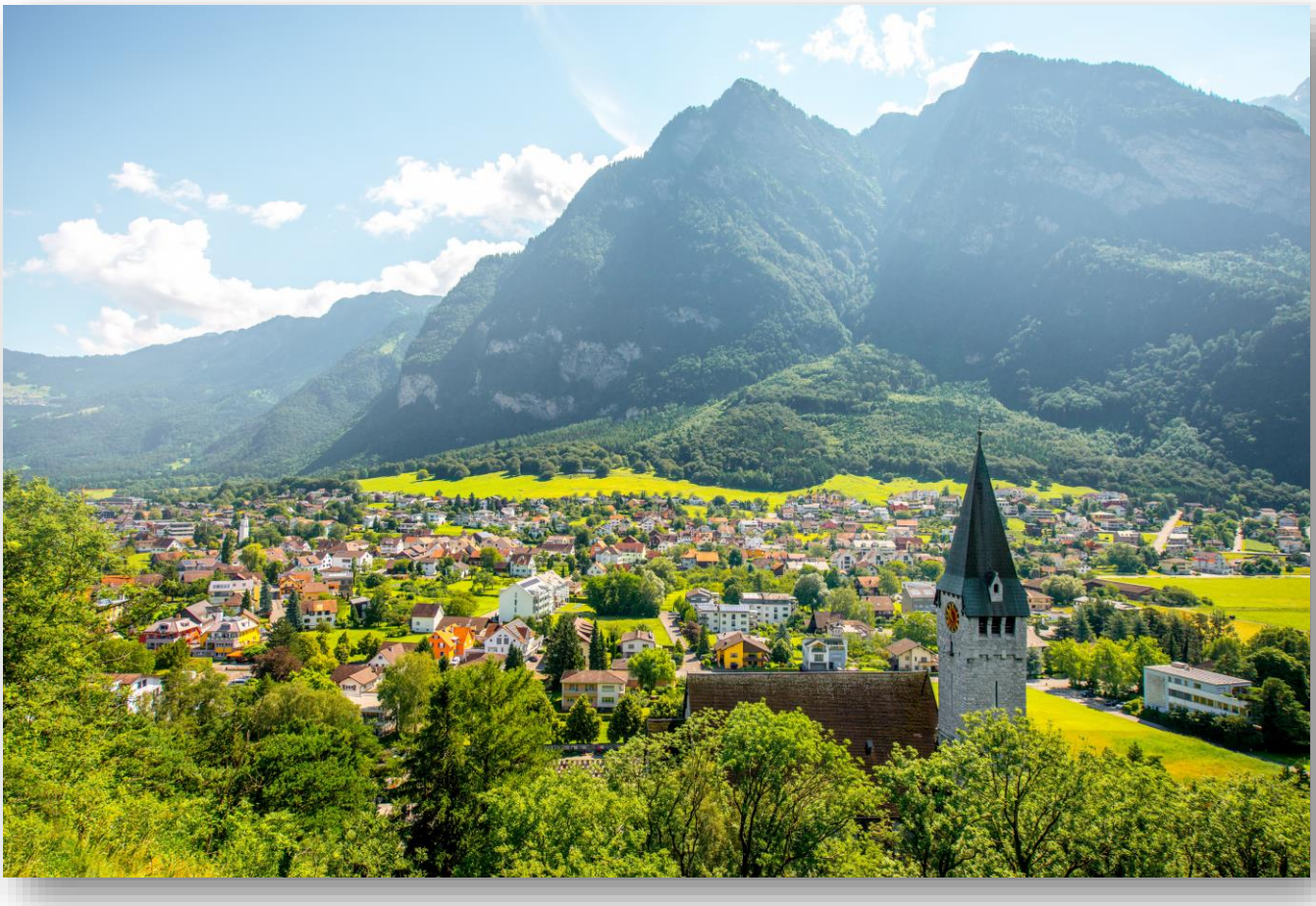
INTERNATIONAL LAWYERS NETWORK



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ESTABLISHING A BUSINESS ENTITY IN LIECHTENSTEIN

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN LIECHTENSTEIN

The Principality of Liechtenstein lies at the centre of Europe, nestled between Switzerland and Austria, next to the river Rhine.

The form of government is a constitutional monarchy established on democratic parliamentary principles. The head of state is the reigning Prince von und zu Liechtenstein, Hans-Adam II. Since 15th August 2004, his son, Crown Prince Alois, handles the government business.

A total of some 38,000 inhabitants live in 11 municipalities which cover an area of 160 km^2. Approximately 34% of the inhabitants are foreigners. The official language is German, but English is widely spoken.

The Principality of Liechtenstein has been in a customs and currency union with Switzerland since 1924. For this reason, the official currency is the Swiss Franc (CHF). Furthermore, the Principality of Liechtenstein has been a member of the Council of Europe since 1978, a member of the UN since 1990 and a member of the European Economic Area (EEA) since 1995.

The most important economic sectors are the industrial and service sectors, which account for more than 94% of gross domestic product. The financial services sector alone accounts for 30% of this.

Liechtenstein offers ideal infrastructure for establishing business entities which includes liberal company law, an educated and experienced workforce together with efficient government and regulatory institutions.

Liechtenstein is also part of the Schengen free Travel Area.

Types of Entities

Company Limited by Shares (AG)

At an international level, the company limited by shares is the most widely recognised legal form. When the Principality of Liechtenstein joined the European Economic Area, the legal framework for the company limited by shares was brought into line with applicable EU law.

The possible purpose of the company limited by shares covers all types of economic activity within the framework of the applicable statutory regulations, in particular

- international commercial transactions,
- property transactions,
- function as (intermediary) holding company.

The company limited by shares is a legal entity and is registered in the Commercial Register.

Under the articles of association, the minimum capital of a company limited by shares is 50,000.00 CHF/USD/EUR and must be deposited in cash at the time of formation.

The supreme body of the company limited by shares is the shareholder's meeting. The shareholders have a right to the profits and any possible liquidation proceeds.

In addition to registered shares, bearer shares may also be issued. Bearer shares must be deposited with a depositary instructed for this purpose.

The executive board, made up of one or more members, conducts the business and represents the company limited by shares externally. The members of the board represent the company solely or jointly.

The resolution of the supreme body to dissolve the company is followed by the liquidation. The

deletion from the Commercial Register can take place after a fixed period of six months at the earliest.

The company limited by shares is obliged to keep accounts and must appoint an auditor. The balance sheets and notes assessed by the auditors must be submitted to the Commercial Register of Liechtenstein within 12 months of the end of the fiscal year and may be inspected by third parties.

Limited Liability Company (GmbH)

A limited liability company is a corporation with legal personality which can be incorporated by one or more shareholders. The incorporation of a limited liability company is particularly suitable for small businesses because of the lower capital requirement of 10,000.00 CHF/USD/EUR. The entity is therefore also suitable for sole traders. Furthermore, the limited liability company is an internationally recognized company form and has the advantages of limited liability. The assets of the company are liable for the obligations of the company. The purpose of the company can be economic or non-economic but must conform to the law, common sense, and moral standards.

The General Meeting is the supreme organ of the company and takes place once a year. The shareholders are responsible for the management of the company unless other provisions are set out in the Articles. Management of the company can also be delegated to third parties.

A limited liability company must maintain orderly accounts which must be filed with the Commercial Register within twelve months of the financial year end.

The statutory minimum capital is 10,000 and can be in Swiss francs, Euros or US dollars. This can be paid in cash or by way of contribution in kind and must be available to the company at incorporation. The capital can be used by the company once it has been entered onto the Commercial Register. The statutes of a limited liability company can be in any form. However, simplified model articles of incorporation are available from the Ministry for Justice.

Incorporation is usually made by way of Public Deed. However, a simplified foundation process not requiring a Public Deed is also possible, provided that there are a maximum of three shareholders and there is only one manager of the company.

Establishment

The establishment is a typical Liechtenstein legal entity under private law.

The establishment can be deployed either for commercial purposes such as e.g., the settlement of business or property transactions etc., or for non-commercial purposes such as e.g., investment and the administration of investments, holding investments and property etc.

The establishment is a legal entity and is entered in the Commercial Register.

Under the articles of association, the minimum capital for an establishment is CHF 30,000.00, or CHF 50,000.00 if the capital is divided into shares and must be deposited in cash at the time of formation.

The supreme body of the establishment is usually the founder or his legal successor, the owner of the foundation rights. His position is much like that of a proprietor. The founder's rights may be sold, inherited, assigned, or otherwise transferred at any time, but not pledged or otherwise encumbered. As a rule, these are documented in a so-called "declaration of assignment". If the capital is split into shares and, if stipulated in the articles

of association, equity securities can be issued as an alternative.

The executive board, comprising one or more members, conducts the business and represents the establishment externally. The members of the board represent the establishment solely or jointly.

Beneficiaries of the establishment can be appointed by the founder or his legal successor. If no other beneficiaries are appointed, the founder or his legal successor is regarded as sole beneficiary.

The resolution of the supreme body to dissolve the establishment is followed by the liquidation. The deletion from the Commercial Register can take place after a fixed period of six months at the earliest.

If the purpose of the establishment permits commercial activities, then the establishment is obliged to appoint an auditor.

Trust Enterprise (Trust reg.)

This type of entity has a distinctly Liechtenstein character and is extremely versatile. It may be structured in the manner of a corporation, or its main characteristics may be similar to a foundation and, as a result, may be used for commercial or asset management purposes. A trust enterprise can be formed with or without legal personality, although the latter is almost unknown in practice.

The highest organ of a trust enterprise is the settlor or his legal successor, i.e., the person who made the contribution of assets. The trust rights can be transferred, assigned, inherited, or encumbered.

The minimum capital stock is set at 30,000 CHF/EUR/USD. Only the assets of the trust enterprise are liable for the debts. The beneficiaries are usually appointed by the settlor in the by-laws. If no beneficiaries are named in the statutes or in the by-laws, then the settlor is deemed to be the beneficiary. The transactions of the trust enterprise are conducted by the trustee council. It represents the trust enterprise externally and is the authorized signatory.

It is also possible to have a foundation-like trust enterprise which does not have settlors' rights. In that case the powers of the highest body are entrusted to the Board of Trustees. Therefore, there is also no supervision of the fiduciary council by a supreme body. However, a protector can be appointed to oversee the interests of the beneficiaries.

Foundation

The provisions regarding the foundation are laid down in Art. 522 § 1 to 41 PGR (Law of Persons and Companies).

Possible aims of the foundation include:

- asset protection,
- settling the succession,
- securing the economic future of family members or other close individuals in the form of maintenance arrangements, for example,
- functioning as a holding to safeguard a corporate or real estate portfolio,
- perpetuating the life's work of the founder (e.g., art collections),
- charitable purposes.

In principle, the foundation may not pursue an active business run along commercial lines (e.g., trading business). Private foundations are not allowed to set up a commercial business, unless such business is necessary for the proper investment and management of foundation assets, e.g., management of participations in a business. Charitable foundations may also set

up a commercial business if this is necessary for attaining their charitable purpose.

The foundation is established by a founder dedicating assets to a specific purpose in favour of a specific or specifiable beneficiary. Once raised to the status of a legal entity, these assets no longer form part of the private assets of the founder but form the foundation assets.

The minimum capital required to establish a foundation is CHF 30,000.00.

Depending on the purposes of the foundation, common-benefit foundations are distinguished from private-benefit foundations.

Besides the registered foundation which comes into existence upon entry onto the Commercial Register, the so-called *'deposited foundation'* exists for private-benefit foundations. For the deposited foundation, no foundation documents must be filed with the Commercial Register. Therefore, this legal type offers utmost discretion.

The foundation has neither members nor an owner.

After the formation, the founder has only those rights which have been reserved in the articles or by-laws. Quite often the founder reserves the right to amend the articles and by-laws, and in particular the beneficiary regulations.

The usufructuaries of the foundation are the beneficiaries, whereby the payment of distributions to beneficiaries may also be made subject to conditions or rules. The beneficiaries are named by the founder, usually in separate by-laws, resembling a last will and testament. The founder can appoint himself as a beneficiary. In order to protect the rights of the beneficiaries, the law stipulates wide information rights towards the foundation council.

The foundation is administered by the foundation board, made up of at least two members who represent the foundation solely or jointly. The foundation board exercises the wishes of the founder as recorded in the articles and the by-laws. Therefore, the foundation board does not form any intent but only has a serving function.

The founder can vest the foundation board with the authority to execute the founder's will with free and absolute discretion, e.g., regarding distributions to beneficiaries (so-called discretionary foundation). The basis of this free and absolute discretion is always the founder's will, determined in the articles and by-laws of the foundation.

The founder may make provision in the articles of association for further bodies – such as an advisory board, a board of trustees or a protector – to advise and support the foundation board, e.g., when paying out distributions to beneficiaries. These may also exercise a controlling function.

The foundation is dissolved when the objects cannot be achieved anymore, especially when such objects are no longer achievable due to lack of adequate funds or as otherwise provided for in the law. This also applies when all of the foundation's assets have been distributed to the beneficiaries.

Furthermore, the founder can stipulate in the articles that the foundation can be dissolved at any time.

As a rule, the foundation is not obliged to appoint an auditor, except in the case of a charitable foundation.

Trust Settlement

The Principality of Liechtenstein is the only continental European country to have included the common law trust in its legal system.

The trust is established by assigning assets to a trustee, subject to the condition that these assets will be administered in accordance with the wishes of the settlor, with any dividends benefiting specific individuals or institutions. Within the framework of the administration of the assigned assets, the trust may at any time acquire stakes in companies and exercise holding functions.

As in the case of the foundation, the trust can be used to secure assets over the long term and to settle the estate of the settlor.

The assets are not held by a legal entity. Instead, a contractual relationship is established with the trustee. However, the assets assigned to the trustee no longer form part of the assets of the settlor.

The settlor can designate himself as the beneficiary during his lifetime and can designate how the assets are to be used after his death.

Protected Cell Company

The concept of a Protected Cell Company is a relatively new addition to Liechtenstein law. A Protected Cell Company is not a separate legal entity, but rather allows other entities to be split into different segments. Therefore, it allows for additional structuring possibilities under Liechtenstein law.

Possible uses include the allocation of specific assets or benefits to a specific segmented cell of an entity.

Steps and time to establish

As a general rule, an entity will be formed in Liechtenstein by a licensed fiduciary. The fiduciary forms an entity in a fiduciary capacity in its own name, but on behalf of the client.

The formation of an entity usually does not take more than one week. Legal entities are formed by way of an incorporation deed and articles of association which must be filed with the Commercial register. The types of companies outlined above may be formed by one individual or legal entity. The sole exception in this regard is the Company Limited by Shares whose formation requires two founders.

Commercial Registry fees are normally circa CHF 1,000.00 but will be higher if the share capital exceeds CHF 50,000.00.

The Company Limited by Shares, Limited Liability Company, the Trust Enterprise, and the Foundation subject to a duty to register, do not acquire legal personality until they have been entered onto the Commercial Register.

The deposited Foundation and Trust Settlement come into existence as early as upon the signature of the formation documents.

Governance/Regulation

Highest governing body

All legal persons and the Trust Enterprise have a supreme governing body (the members meeting, the holder of founder's rights or another body) vested with the supreme powers, which include, for example, approving the annual accounts, passing resolutions on profit appropriation, appointing the other governing bodies, amending the articles of association, increases in share capital etc. As far as foundations are concerned, these powers are generally vested in the foundation council.

Management Organ

The management organ is the executive governing body of the entity. All legal persons must have an administrative council (board of directors, foundation council or manager) which, unless provided for otherwise, may consist of one or more individuals or legal entities or firms and is generally appointed by the highest controlling organ.

Requirement for local directors/shareholders

It is generally required that at least one member of the administrative body be the holder of a Liechtenstein trustee licence. This does not apply to legal persons which are governed by the Trade Act or any other special Act and must have one qualified manager.

There is no requirement for Liechtenstein shareholders.

Auditors

The appointment of an auditor is generally required for a Company Limited by Shares. Insofar as a (i) Limited Liability Company (ii) Establishment (iii) Trust Enterprise or (iv) registered Foundation operate a commercially active business or their purpose, as set out in the articles of association, allows such a business to be operated, they also require an auditor. An auditor must generally also be appointed for Foundations which are subject to supervision by the Foundation Supervisory Authority, e.g., charitable foundations.

Ongoing maintenance

Accounting for companies engaging in commercial activities

Any legal person subject to a duty to register which operates a commercially conducted business is required to maintain proper accounts (i.e., draw up annual accounts consisting of a balance sheet, the profit and loss statement and notes (if any)). The company limited by shares and limited liability companies are required to keep proper accounts, even if a commercially conducted business is not operated.

Legal persons required to do accounting must draw up the annual accounts in the German language and must be denominated in Swiss francs, euros, or US dollars. The annual accounts must be filed with the tax administration and, if necessary, with the Commercial Register on an annual basis.

Bookkeeping for entities not engaging in commercial activities

Legal persons not required to do proper accounting (deposited Foundations, Establishments and Trust Enterprises not engaging in commercial activities) as well as trust settlements must, taking into consideration the principles of orderly bookkeeping, maintain appropriate records of the financial circumstances and keep documentary evidence presenting a comprehensible account of the course of business and movement of assets.

Establishments, Trust Enterprises, and registered Foundations which do not operate a commercially conducted business and whose purpose as laid down in the articles does not allow such a business to be operated must draw up an annual statement of assets and liabilities.

Representative

The legal representative is the official address for service of documents and provides a link to the domestic court and administrative authorities. The law does not require any legal representative for trust settlements.

Minority shareholders' rights and protection

General Meetings

The general meeting of shareholders is the highest controlling organ of the Company Limited by Shares and Limited Liability Company. There must be at least one Annual General Meeting to approve the financial statements and deal with other statutory matters.

Shareholder Complaints

Shareholders have a general right of complaint to the ordinary Liechtenstein Courts. There is no other supervisory authority, except for charities.

Foreign Investment

Investment fund centre

Modern and liberal investment fund legislation is one of the pillars of Liechtenstein's financial centre. A key expression of this is the Liechtenstein Investment Undertakings Act and the associated Ordinances.

Moreover, the Liechtenstein Collective Investment in Transferable Securities Act came into force on 1 August 2011. This had the effect of implementing the EU's UCITS IV Directive in Liechtenstein. The Act further strengthened access to the single European market for harmonised, standardised investment funds, known as UCITS (Undertaking for Collective Investment in Transferable Securities).

Benefits of Liechtenstein as an investment fund centre

State-of-the-art investment fund centre: The Liechtenstein Investment Undertakings Act ("IUG") came into force in the year 1996 and was extensively revised in the year 2005. This has given Liechtenstein a very modern, liberal, and client-focused legal foundation for investment funds. The Liechtenstein Undertakings for Collective Investment in Transferable Securities Act ("UCITSG"), which came into force in August 2011, strengthens access to the EU market for harmonised, standardised investment funds.

International compatibility of Liechtenstein investment funds: Through its membership of the European Economic Area (EEA) and the implementation of all relevant EU Directives, Liechtenstein has created thoroughly unbureaucratic and discrimination-free access to the European market.

Unbureaucratic establishment of investment funds: Firstly, a fast and unbureaucratic approvals process involving the Liechtenstein Financial Market Authority ("FMA") is anchored in law. This also stipulates a maximum period for standard products. In addition, investment funds for qualified investors can also be set up quickly using a simplified approvals process.

Emphasis on investor protection: The provisions of Liechtenstein investment fund legislation place a particular emphasis on investor protection. The business activities of investment fund management teams are monitored on an ongoing basis by the state supervisory authority and statutory auditors, who require approval from the Financial Regulator.

Individual solutions: Liechtenstein investment fund legislation makes provision for highly customised solutions, including for individual investors, in particular under the heading of so-called "private label funds".

Taxation

There is no withholding tax upon the payment of dividends or distributions by a Liechtenstein entity. Generally, corporation tax is charged at 12.5% of calculated net profit, subject to a minimum annual charge of CHF 1,800.00.

Subject to fulfilment of the necessary conditions, entities not engaging in economic activities can apply to the tax authorities for recognition as a Private Wealth Structure (PWS). A PWS is subject to a flat annual tax of CHF 1,800.00 and is exempt from ordinary corporate income taxation.

VAT is charged at a rate of 7.7%. There are no thin capitalization rules in Liechtenstein.

This Memorandum is for information purposes only and reflects Liechtenstein law in September 2020.

This Memorandum does not constitute legal advice and cannot replace personal consultation on a case-by-case basis. If you have any further questions about establishing a business in Liechtenstein or need general legal advice, please contact Egon Hug (e.hug@advokatur.li) or Martin Zech (m.zech@advokatur.li).

Müller & Partner Attorneys at Law was founded in 1998 under the leadership of Dr. Wolfgang Müller and has developed into one of the most prestigious law firms in the Principality of Liechtenstein. The firm specializes in litigation matters and represents clients before the Courts and other authorities in Civil, Criminal and Public Law. In this context Müller & Partner Attorneys advise and represent foreign and domestic private clients as well as corporations and, in relation to the latter, well-known insurance companies, banks, investment advisors, trust companies and investment companies. The firm also advises in all legal areas, including corporate structuring and taxation.

Müller & Partner Attorneys also have long standing relationships with licenced Trustees and Asset Managers who can provide any necessary fiduciary, accounting, audit, taxation, and asset management services needed to facilitate the establishment and maintenance of a new business entity. In particular the firm cooperates closely with its partner firm Juricon Trust Company Establishment which is based in the same office building as Müller & Partner.

Juricon is a well-known fully licenced fiduciary which is registered with the Liechtenstein Financial Regulator. Based on the legal advice received from Müller & Partner, Juricon can provide support for the swift establishment of a new structure.

Fall 21

INTERNATIONAL LAWYERS NETWORK

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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 Liability 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. After the third quarter of 2021, there were 136,152 UAB and over 288 AB registered with the Register of Legal Entities.

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. 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 million, asset balance value exceeds EUR 1.8 million, average annual number of employees exceeds 50. The auditor is elected, and his/her remuneration is set by the shareholders of the company;
- bodies of the company: the general meeting and the head of the company are mandatory bodies for UAB and AB. One of the collegiate bodies (the board or the supervisory board) is mandatory for AB while formation of collegiate bodies for UAB is optional. For more comprehensive description of the bodies of the company, please refer to Article 3.1 below.
- public trade of shares and bonds: AB and UAB can be listed in a stock exchange and sell its securities publicly. However, UAB cannot issue convertible bonds that are publicly tradeable.

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 with the Register of Legal Entities) or after the establishment of a company 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, merger / spin-off procedures, 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 distinct legal entities from the parent company. A branch is a structural subdivision of a legal entity, having its own registered office and performing all or part of the functions of the legal entity. A representative office is a subdivision of a legal entity, having its own registered office and having a right to perform certain actions on behalf of the legal entity. Legal entity assumes all obligations of a branch or a representative office.

A branch and a representative office perform their activities under the regulations approved by the legal entity.

A branch or a representative office is established upon the decision of the founder (legal entity) to establish a branch or a representative office. Also, regulations of a branch or a representative office shall be prepared.

There are no share capital requirements applied to a branch or a representative office under Lithuanian law.

2. Steps and Timing to Establish

Generally, a company is established in two steps: (i) adopting foundation documents and (ii) registering the company with the Register of Legal Entities.

To establish a new company (the most common corporate structures for foreign investors – AB and UAB), the following main steps must be taken:

- making an interim name reservation (optional);
- signing of an Act of Incorporation (or Agreement of Incorporation in case there are two or more founders). The Act of Incorporation of UAB may also incorporate information about the founder, 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 accumulative account at a bank;
- transferring of initial contributions to the accumulation account (always not less than EUR 2,500 in case UAB is being established and not less than EUR 25,000 when AB is being established);
- signing of the Articles of Association;
- drafting of a Report on Establishment of a Company (applicable to AB only) that shall be approved by the Founders' Meeting;
- 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);
- notarizing the establishment documents at the notary;
- registration of documents with the Register of Legal Entities;

- making entries into the securities' accounts of each shareholder (applicable to UAB);
- submission of shareholders' list to the Information System of Legal Entities Participants (JADIS) (applicable to UAB).

Please note that in case the founder of a company is a foreign legal entity, 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 entity is stored and copy of articles of association of the legal entity). 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 (optional);
- adoption of a decision by a competent body of the founder to establish a branch or representative office in Lithuania, to appoint a manager (head) 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 Entities.

In addition to the above-mentioned documents of the foreign founder the annual financial statements for the last financial year and consolidated financial statements, if such statements are required by the laws of a foreign state, must be submitted to the Register of Legal Entities 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). Also, copies of personal documents of persons authorized to act on behalf of the founder shall be required.

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 Entities.

There is also a possibility to register UAB online. However, there are certain requirements that must be met:

- the founder must be a natural person;
- the founder must be a single person;
- the founder must have a qualified e-signature;
- the Articles of Association and the Act of Incorporation of UAB shall be of the form approved by the Government;
- the name of UAB must be reserved in advance and not include a word "Lithuania" in it;
- the premises whereat UAB shall be registered must be solely owned by the founder and the founder should have a right to freely dispose of it (the premises are not seized, pledged, mortgaged, etc.);
- the authorized capital must be paid by monetary contributions.

While registering UAB online, there is no need to visit a bank for opening of an accumulative bank account. Online system allows to select the commercial bank operating in Lithuania whereat an accumulative bank account may be remotely opened under UAB's name.

3. Governance, Regulation and Ongoing Maintenance

3.1 Corporate Governance

The company (UAB and AB) shall always have the general meeting of shareholders and the head of the company. The board (collegiate management body) is not a mandatory body in UAB, whereas in AB at least one collegiate body shall be formed (the supervisory board or the board). In case the supervisory board is not formed in a listed AB, the supervisory functions shall be delegated to the board.

The general meeting of shareholders shall be the highest decision-making body. The annual general meeting of shareholders shall be convened no later than 4 months after the end of financial year of the company.

The head of the company (CEO) shall be a single-person management body of the company. The CEO must be a natural person. The company shall be solely represented by the CEO acting on behalf of it, he/she has a duty to ensure the day-to-day activities of the company.

Members of the management board must be natural persons and members of supervisory board may be natural persons or legal entities. At least 1/2 of the supervisory board members and the members of the board which performs the supervisory functions shall be not employed at the company. At least 1/3 of the members of supervisory board of listed AB as well as the members of the board of listed AB which performs the supervisory functions must meet the statutory independence requirements (e.g., not have an employment relationship with the company, parent company or subsidiaries for at least one year, not to be a member of the company's collegial body for more than 10 years, etc.). Specific laws that regulate activity of the company it is engaged in, soft law or company's policies may provide for additional independence requirements.

Members of the management board and the CEO 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.

Member of the management board and the CEO of the company who fails to perform or performs improperly his/her duties set in laws or incorporation documents (e.g., duty of confidentiality, care) must redress all damage incurred on the company, if all the conditions of civil liability are proven (unlawful actions, damage, causal link between unlawful actions and damage and fault).

An audit committee must be formed in a company if it meets the criteria of a public interest entity (e.g., listed AB, banks, Central Credit Union, insurance company, etc.). The audit committee shall be responsible for supervision of financial reporting and audit process, the effectiveness of internal quality control, risk management and internal audit systems as well as the related party transactions.

The general meeting of shareholders of listed AB at least every 4 years shall approve the remuneration policy. The remuneration policy shall define the remuneration of the CEO and members of the board and supervisory board. The remuneration policy as well as the results of the general meeting of shareholders which has approved the policy shall be made publicly available on company's website during all its' validity period.

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 Entities 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.

There are no specific educational requirements for the CEO and members of the board, except for the requirement that they must be natural persons, under the general corporate laws. Nevertheless, specific laws that regulate activity of the company it is engaged in, or soft law may define certain requirements applicable for the CEO and members of the board.

Regarding to employment of the CEO from foreign countries please refer to Article 4.4 below.

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/her 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 company may refuse to grant the shareholder the access to such information and/or documents if they are related to confidential information or commercial (industrial) secret unless the shareholder provides a written pledge not to disclose the commercial (industrial) secret or confidential information. The company must grant access to the shareholder to other information of the company and/or provide copies of the documents if such information and documents, including information and documents, related to confidential information and commercial (industrial) secret of the company, are necessary to the shareholder to fulfil the requirements set by legal acts;
- shareholders owning not less than 1/10 of the company's shares have 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 have a right to propose a supplement to the agenda for the general meeting of shareholders;

- 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 entity or legal entity'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 entity's member whose actions contradict the goals of legal entity's activities and where there are no grounds to expect any changes in the said actions. Shareholders of public limited liability company are not entitled to the right described herein.

Please note that shareholders of a legal entity 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.

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%; or
- any company which is a part of the debtor's company group (a company group exists when a parent company directly or indirectly holds more than 25 percent of shares, interests, member shares, voting rights or rights to a share in distributable profits or exclusive rights to acquire them).

Additional interest deduction limitation rules apply to interest expenses incurred due to loans from all parties. Entities can fully deduct interest expenses that do not exceed interest income and deduct any excess amount of interest expenses that do not exceed 30% of earnings before interest, tax, depreciation, and amortization (EBITDA) or up to EUR 3,000,000. EBITDA and the deductible amount of interest expenses are calculated on a group level.

Entities that are members of a consolidated group are allowed to fully deduct interest expenses for financial accounting purposes if they can demonstrate that the ratio of their equity over their total assets is not more than 2% lower than the equivalent ratio of the group and all assets and liabilities are valued using the same method as in the consolidated financial statements. Interest expenses that are non-deductible

in a year may be carried forward for an unlimited period of time.

4.1.2. Related-party Transactions

Transfer pricing (TP) rules apply to transactions between a Lithuanian resident company and a person associated with the resident company (a controlled transaction).

Transfer pricing documentation rules apply to domestic and cross-border transactions with associated enterprises. A master file shall be prepared by the companies that belong to a multinational entity group and whose revenue during the previous tax year exceeded EUR 15,000,000. A local file shall be prepared by the companies whose revenue in the previous tax year exceeded EUR 3,000,000. The preparation of a local file is not required for domestic transactions carried out during the tax year of 2020 and subsequent years. However, the taxpayer is expected to be able to justify the transfer pricing of domestic transactions if requested by the tax authorities.

Transfer pricing documentation may not be prepared if the value of a transaction or transactions with an associate person per year does not exceed EUR 90,000 (except for transactions with a person, registered or organized in listed tax havens).

Lithuanian tax authorities apply the transfer pricing methods which basically follow the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

4.1.3. Permanent Establishment

A permanent establishment of a foreign entity in Lithuania is subject to the CIT rate of 15%.

A foreign entity is regarded 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 covers 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), the foreign entity may also be deemed having a permanent establishment in Lithuania.

The two second conditions, based on which it is established whether or not a foreign entity performs its activities in Lithuania through its permanent establishment, are:

- a representative/agent through which the activity is performed,
- the use by a foreign entity in Lithuania of a construction site, a construction, assembly or equipment facility, equipment or structures for prospecting or extraction of natural resources in Lithuania.

4.1.4. Withholding Taxes

Dividends

A 15% withholding tax is applied to dividends paid by a Lithuanian company to a foreign company.

Full participation exemption is applicable to 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 objective is to get a tax benefit, which conflicts with Council Directive 2011/96/EU.

Interest

Interest paid to non-resident companies is generally subject to a 10% withholding tax.

No withholding tax is applied to interest paid to resident companies in EEA countries or countries having a tax treaty with Lithuania.

Other exemptions include interest on government securities issued in international markets, deposit interest and interest on subordinated loans meeting the criteria prescribed by the Bank of Lithuania.

Royalties

Royalties paid to non-resident companies are subject to a 10% withholding tax.

No withholding tax is applied to royalty payments if the recipient is an associated company of the paying company and is a 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 company 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 until royalty payment.

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.

A 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 members of supervisory boards. 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 foreign entities (including branches) in Lithuania are subject to corporate income tax on 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 (its average number of employees does not exceed 10 persons, and its taxable income during the taxable period is less than EUR 300,000, taking into consideration the total average number of employees ant the total annual income of associated companies) may be exempt from CIT for the first tax period and entitled to a reduced rate of 5% for subsequent tax periods.

Income earned from the commercialization of scientific research and experimental development production is subject to a reduced rate of 5%.

Ordinary losses of up to 70% of taxable income in 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 corporate taxpayers who have been implementing investment projects (e.g., acquisition of fixed assets such as machinery and equipment, trucks and trailers, computer hardware and software, communication equipment and rights), taxable profits may be reduced up to 100%.

R&D costs may be deducted by a triple amount in the taxable period when they are incurred.

Companies established in free economic zones are exempt from corporate income tax for the first 10 years following the date of capital investments and they are subject to a 50% reduction in the CIT rate for 6 subsequent years:

- if capital investments are not less than EUR 1,000,000 and the companies meet certain other conditions;
- if capital investments are not less than EUR 100,000, the average number of employees is not less than 20 in the financial year, and the companies meet certain other conditions.

4.1.7. Employment Related Taxes

The government of Lithuania has set forth the minimum pay (EUR 3,93 per hour) and minimum monthly wage (EUR 642 per month). The hourly pay or monthly wages of an employee may not be lower than the minimum hourly pay or the minimum monthly wage. The minimum monthly wage can only be paid for unqualified work.

Taxes that shall be deducted from the agreed employee wage are the following:

- personal income tax (standard rate is 20%, any portion exceeding EUR 81, 162 (60 average monthly wage) is subject to taxation at a rate of 32%);
- social insurance tax (19,5%);
- pension saving contributions (2,4% or 3%, if selected by employee).

The employer shall pay in addition the social insurance tax (1,77% in case the employee is employed for unlimited term, 2,49% in case the employee is employed for a fixed term).

The amount of 60 average wages (EUR 81, 162) shall be calculated in accordance with the annual income as provided below:

- income related to an employment relationship or other relationship that corresponds to the employment relationship;
- bonuses and remuneration for the activities at the supervisory board, management board or the loan committee;
- income received from the employer under the copyright agreements;
- income received by the heads of small partnerships who are not members of those small partnerships under a civil (service) contract for the management activities.

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 Lithuanian sources:

- employment income;
- distributed profits, including dividends;
- any payments made to members of the management board or the supervisory board;
- interest;
- royalties;
- income from the lease 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%. However, the share of annual income exceeding EUR 162,324 is subject to a 20% rate.

Employment-related income and payments made to members of the management board, or the supervisory board are subject to taxation at a rate of 20%, any portion exceeding EUR 81,162 is subject to taxation at a rate of 32%.

Income from distributed profits and individual activities derived through a fixed base maintained in Lithuania is subject to a 15% rate.

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 (due to pregnancy, childbirth, acute illness, studies, professional training, or assignment to another EU Member State or a third state). 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.

The same rights and requirements are vested to the citizens of the European Free Trade Association (EFTA) Member States (Iceland, Norway, Switzerland, and Liechtenstein).

4.4.2 Visa Requirements

Citizens of certain countries may enter Lithuania without a visa. A list of these countries may be found on the website of the Ministry of Foreign Affairs 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. Documents for the issuance of a national visa may also be submitted to Vilnius, Kaunas, Klaipėda, Šiauliai or Panevėžys territorial divisions of the Migration department if the foreigner is staying in Lithuania legally.

4.4.3 Residence Permits

A foreigner could get the temporary or permanent residence permit to live in the Republic of Lithuania. The temporary or 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, studying and family reunification.

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 renewed.

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 national visa or 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 CEO, 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 employees who are citizens of the Republic of Lithuania or has permanent residence permit to live in the Republic of Lithuania with the monthly earnings in total at least 2 monthly average wages (gross); (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 the temporary residence permit must be submitted to any migration office in the territory of Lithuania (prior submission of an application and registration for migration services online through the Lithuanian Migration Information System (MIGRIS) is required). The lodging of such application is not entitling a foreigner to stay in the territory of the Republic of Lithuania before the application is examined and a decision is taken. The 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 highly qualified employees, start-up 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 the abovementioned exceptions.

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INTERNATIONAL LAWYERS NETWORK

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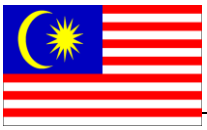
ESTABLISHING A BUSINESS ENTITY IN MALAYSIA

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: -

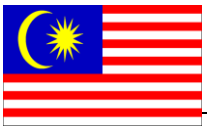
(a) by an individual operating as a sole proprietor; or
(b) by two or more (but not more than 20) persons in partnership; or
(c) by a limited liability partnership (LLP); or
(d) by a locally incorporated company or by a foreign company registered under the Companies Act, 2016 ("Act"). A company is a 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. The Act, which replaced the Companies Act, 1965 (the "1965 Act") 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 (save for a company limited by guarantee[18]).
(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 companies may pass a members' resolution by way of written resolution in lieu of meetings. The passing of the resolution need not be unanimous.

[18] By virtue of section 31 (1) and 38 (1) of the Act, a company limited by guarantee is mandated to have a constitution.



(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 to 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 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[19]. 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[20]. 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 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.

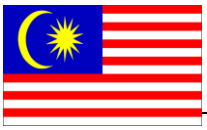
According to section 11 (2) of the Act, a company limited by guarantee shall be a public company.

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[21]. According to section 11 (3) of the Act, an

[19] section 10 (2) of the Act.

[20] section 10 (3) of the Act.

[21] section 10 (4) of the Act.



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[22]:-

(a) any company which immediately prior to the commencement of the Act was a private company under the repealed written laws;
(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[23]:-

(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[24]. 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[25].

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.

In addition to the above, the other main differences between a private company and a public company are as follows:-

1. the statutory minimum number of resident directors for a private company is one (1) whereas a public company is required to have a minimum of two (2) resident directors;

2. only a private company can pass a written resolution[26];

[22] section 2 of the Act.

[23] section 42 and 43 (1) of the Act.

[24] section 2 of the Act.

[25] section 41 (2) of the Act.

[26] section 290 of the Act.

3. only a public company is mandated to hold its annual general meeting;

4. certain categories of private companies may be exempted from having its financial statements audited[27], which allows startups and small and medium-sized enterprises to enjoy cost-savings in the running of their business.

(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, a "foreign company" is defined as[28]:-

(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 foreign company with the Registrar of Companies[29]. 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

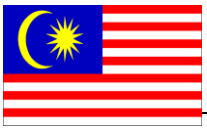
In addition to the above, a representative office or a regional office may also be set up by a foreign company / organisation in Malaysia to perform permissible activities for its head office / principal. The major difference between a local company and a representative/regional office is no commercial 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

[27] section 267(2) of the Act. The qualifying criteria for private companies to be exempted from appointing an auditor for a financial year are set out in CCM's Practice Directive No. 3/2017. The types of private companies that can decide to opt for audit exemption are (i) dormant companies; (ii) zero-revenue companies; and (iii) threshold-qualified companies with annual revenue of not more than RM100,000 during the current financial year and in the immediate past two (2) financial years, total assets of not more than RM300,000 in the immediate past two (2) financial years and not more than 5 employees at the end of its current financial year and in each of its immediate past two (2) financial years end.

[28] section 2 of the Act.

[29] section 561 (1) of the Act.



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. However, they are not subject to any equity condition since they do not have issued capital in 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 RM300,000 per annum and must be completely funded from sources outside Malaysia.

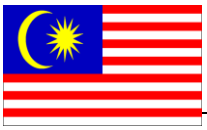
Procedure of incorporating a local company

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[30] and the proposed name will be reserved for thirty (30) days from the date of lodgement of the application together with the prescribed fee[31].

Once the name is approved and reserved, the applicant is required to lodge an application for

[30] 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.

[31] section 27 (5) of the Act.



incorporation to the CCM, which shall include a statement by every person who intends to form a company containing the following particulars[32]:-

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 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[33]:

(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.

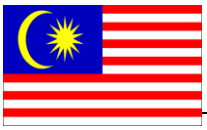
As seen above, the multiple and various types of incorporation documents required under the 1965 Act such as the memorandum and articles of association, statement of compliance and statutory declaration by each promoter and first directors of the proposed company are no longer required and the process 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[34], 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,

[32] section 14 (3) of the Act.

[33] section 14 (4) of the Act.

[34] section 20 of the Act.



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[35].

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.

As mentioned earlier, a private company shall have a minimum of one (1) director while a public company shall have a minimum of two (2) directors[36]. The minimum number of directors excludes alternate or substitute directors and is required to satisfy the following criteria by proving that the director(s):

(a) is/are ordinarily resident in Malaysia[37]; 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[38]:-

(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;

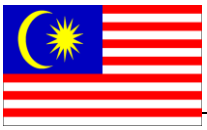
(e) in the case of a foreign company limited without share capital, the amount up to which the member undertakes to contribute to the assets of the foreign

[35] section 21 (1) of the Act.

[36] section 196 (1) of the Act.

[37] the 1965 Act did not focus on the residency requirement as long as the minimum number of directors has his principal or only place of residence within Malaysia.

[38] section 562 (1) of the Act.



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[39].

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[40].

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, where income is taxable on a world income scope. 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 ("YA") 2021, the income tax rate for small and medium-sized enterprise ("SME") is as follows:-

- 17% on first RM600,000 chargeable income; and
- 24% for any chargeable income in excess of RM600,000.00.

SME refers to a resident company incorporated in Malaysia with an ordinary paid-up share capital of not more than RM2.5 million and gross business income of not more than RM50 million and such company must not be related to another company with ordinary paid-up share capital of more than RM2.5 million.

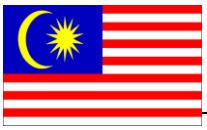
For resident companies with paid-up capital more than RM2.5 million at the beginning of the basis period and a non-resident company / branch[41], the corporate tax rate is 24%.

Incentives

[39] section 562 (2) of the Act.

[40] 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 Minster has directed the CCM not to accept for registration.

[41] 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.



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 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.

The major tax incentives for companies investing in the services sector are the Pioneer Status and the Investment Tax Allowance.

A company approved with a Pioneer Status certificate can enjoy income tax exemption between 70% - 100% of statutory income for 5 to 10 years, whereas, for Investment Tax Allowance, a company can get allowances between 60% - 100% on qualifying capital expenditure incurred within a period of 5 to 10 years. For projects with a longer gestation period and high capital expenditure, it would be more beneficial to opt for Investment Tax Allowance. Eligibility for Pioneer Status and Investment Tax Allowance is based on certain priorities, including the level of value-added, technology used and industrial linkages. Eligible activities and products are termed as "promoted activities" or "promoted products". For further details, please refer to the website of Malaysian Investment Development Authority at www.mida.gov.my.

Lastly, as one of the many countries that has been affected by the covid-19 lockdown measures, several tax incentives and short-term economic recovery plans have been introduced to stimulate the nation's economy, which include the following:

- Accelerated capital allowance is given for qualifying capital expenditure incurred on machinery and equipment including Information and Communication Technology Equipment from 1 March 2020 to 31 December 2021 where the annual allowance is increased to 40%;
- Double deduction is given on pre-commencement expenses incurred by International Shipping Companies for setting up regional offices in Malaysia where the application should be made to Malaysian Investment Development Authority not later than 31 December 2021;
- In order to encourage the establishment of new SME, an annual income tax rebate of up to RM20,000 for the first 3 years of assessments is given to an SME which registers and starts its operations from July 1, 2020, until December 31, 2021;
- The existing tax incentives for companies in the manufacturing sector relocating their operations to Malaysia is revised as follows:-
    - The period for applying to the Malaysian Investment Development Authority ("MIDA") for the manufacturing sector is extended by one (1) year to 31 December 2022; and
    - The scope of the tax incentives is expanded to companies in

selected service sectors, including companies adapting Industrial Revolution 4.0 and digitalisation technology, with investment that contributes to a significant multiplier effect in the following services:-

i. Provision of technology solutions, or more typically a technology company which develops technology and provides technology solutions based on substantial scientific or engineering challenges;
ii. Provision of infrastructure and technology for cloud computing;
iii. Research and development/design and development activities;
iv. Medical devices, testing, laboratory, and clinical trials; and
v. Any services or manufacturing-related services as determined by the Ministry of Finance.

The tax incentives provided are:

- For a new company:
  - Income tax rate of 0% to 10% for a period of up to 10 years;
- For an existing company with a new services segment:
  - Income tax rate of 10% for a period of up to 10 years.

The period for applying to MIDA for the tax incentives for the services sector is from 7 November 2020 until 31 December 2022.

- In order to enhance and simplify the tax incentive for trading activities previously covered under the Principal Hub activities which was subject to higher eligibility criteria, a new incentive scheme known as "Global Trading Centre" has been introduced, whereby a 10% income tax rate for 5 years (which is renewable for another 5 years), is given under this tax incentive. Applications must be received by MIDA between 1 January 2021 and 31 December 2022.
- Manufacturers of pharmaceutical products including vaccines (especially COVID-19 vaccine) will be given the following tax incentives:
  - Income tax rate of 0% up to 10% for the first 10 years; and
  - Income tax rate of 10% for the subsequent period of 10 years.

Further, strategic investments by such companies may be considered for other benefits, including grants, import duty/sales tax exemption for machinery and equipment, as well as raw materials. Applications for this incentive must be

received by MIDA between 7 November 2020 and 31 December 2022.

- The following deduction on research and development ("R&D") expenditure is given to tax resident only:
    - Single deduction under Section 34 (7) of the Income Tax Act ("ITA");
    - Double deduction under Section 34A of the ITA;
    - Double deduction under Section 34B of the ITA.

  The double deduction under Section 34A in respect of R&D expenditure incurred outside Malaysia shall not be more than 30% of the total R&D expenditure for a year of assessment. Where the 30% limit is breached, only a single deduction is given on the R&D expenditure incurred.
- 100% investment tax allowance for 5 years for Malaysian companies to relocate their overseas manufacturing facility in Malaysia with a minimum investment of MYR300 million, which application shall be made from 1 July 2020 to 31 December 2021;
- Special reinvestment allowance ("RA") is given for qualifying expenditure incurred by companies engaging in manufacturing and selected agriculture activities from YA 2020 to YA 2022, whose RA incentive period has expired;
- Donations / contributions in cash / in-kind to fight against the COVID-19 outbreak are allowed for tax deductions;
- Tax incentives offered by the Malaysian Global Innovation and Creativity Centre on behalf of the government to those contributing towards social enterprises' crowdfunding activities that address social and environmental challenges, where corporate or business donors of a successful Social Impact Matching Grant grantee may receive tax receipts of up to 10% of their aggregate income for cash contributions made between 1 August 2020 and 31 July 2021. Social enterprises are businesses that proactively create a positive social or environmental impact in a financially sustainable manner.

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INTERNATIONAL LAWYERS NETWORK

ACUMUM LEGAL & ADVISORY

ESTABLISHING A BUSINESS ENTITY IN MALTA

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN MALTA

Introduction

With its corporate laws based upon those of the UK, Malta has incorporated laws and principles into its own legislation, providing comfort and security to the commercial and business community. The most common form of business entity being set up in Malta is the limited liability company, which is mostly used for holding or trading activity. However, various other forms of entities may be set up in order to conduct business in Malta, as will be shown below.

Malta has been a member state of the European Union since 2004 and it officially entered the Eurozone in 2008, cementing its position as a player in the global financial services industry and making it ideal as a destination for business. Malta's highly efficient corporate tax regime is perhaps one of the most attractive aspects of setting up a business entity in Malta. At the forefront of the incentives which encourage foreign business to establish operations in Malta, is the fact that Malta's strategic geographical location in the Mediterranean facilitates access and commercial connections to mainland Europe and the rest of the EU, as well as North Africa and the Middle East. Language is also not a barrier – although Malta has its own language (Maltese) English is also an official language, with most people also being able to speak other languages including Italian and French.

Although small, Malta's size does indeed offer advantages. The Malta Financial Services Authority (MFSA) is the main regulator of financial services on the island and is easily accessible. The tight-knit business community facilitates networking and provides ample opportunity for building a client base.

The below table has been created with the aim of providing a general overview of the steps to be taken to set up various types of business entities in Malta and the characteristics of each.

1. Types of Business Entities, Characteristics and Management

NAME OF ENTITY	SET-UP REQUIRMENTS, CAPITALISATION AND CHARACTERISTICS	MANAGEMENT
Limited Liability Company	• Capital is divided into shares which are held by its shareholders. The shareholders' liability is limited to the amount unpaid on the shares they hold; • Name must end with 'limited' or 'ltd;' • Minimum share capital of €1,164.69, of which at least 20% of the value must be paid up; • At least one shareholder, but not more than 50 shareholders; • Shares and debentures cannot be offered to the public; • Right to transfer shares is restricted.	• Minimum of one director; • Decisions are taken by Board Resolutions or Shareholders' Resolutions – ordinary or extraordinary. These may be taken by round robin; • Annual General Meetings are used to present accounts and reports, declare dividends, and appoint directors. All other business is conducted during Extraordinary General Meetings.
Public Liability Company (PLC)	• Shares can be sold to the public, with no share transfer restrictions; • The company's name must end with 'public limited company' or 'p.l.c;' • Minimum share capital of €46, 587.47, of which at least 25% of the value must be paid up; • Proposal of shares to the public: shares must first be offered on a pre-emptive basis to its existing members in proportion to the share capital held by them.	• Minimum of two directors to satisfy the four-eye principle for more accountability and transparency; • Decisions of the shareholders are taken through resolution – higher majorities required than those for a private company; • Directors of a public company must consent to act as such, either by signing the memorandum of association or by delivering their consent in writing to the Registrar of Companies.
Partnership en nom collectif	• Partners: two or more legal or natural persons; • Deed of partnership is entered into by a private writing, or a public deed registered with the Malta Business Registry; • Liability of the partnership is limited to the amount of contribution which is unpaid by the partners; • Each partner is liable for the obligations and debts of the partnership with all their present and future property. The liability of the partners between themselves is divided proportionately.	• Each partner is a managing partner, unless the deed of partnership establishes otherwise; • Each can administer, represent, and bind the partnership; • Each partner is entitled to vote at meetings, have a share of the partnership's profits and control and administer the partnership's affairs.

	• The partners can be both individuals and body corporates.	
Partnership en commandite The 'Limited Partnership'	• General partners have unlimited and joint and several liability towards the obligations of the partnership, while the limited partners are only liable up to the amount unpaid on their contribution. • Obligations of the partnership are guaranteed by the unpaid contribution of the limited partners. • Deed of partnership to specify which are limited partners and which are general- in default partnership will be assumed to be a partnership *en nom collectif*.	• The general partners are responsible for the administration and management of the partnership. • The partners decide as to which of them will administer the partnership and who has the power to dismiss such partner from office; • A limited partner cannot perform any acts of administration nor transact business on behalf of the partnership, unless empowered through a power of attorney to carry out specific acts.
European Economic Interest Grouping (EEIG)	• For 2 to 20 persons wishing to develop their economic activity; • entity has separate legal personality; • Profit making cannot be an aim of the EEIG, although this can be made in the process of conducting its activities; • The EEIG is formed in line with the law of an EU member state. They must have their registered office in the EU; • The public cannot be invited to invest in it, and it cannot employ more than 500 people.	• Must have at least two organs: the members acting collectively and the managers; • The managers represent and bind the entity in its dealings with third parties; • Members each have one vote although members can hold more than one vote. However, one member cannot hold the majority of the voting rights.
INVCO	• Public investment company (INVCO p.l.c.) having a fixed share capital, with the object of investing in funds to spread investment risk and give its members the benefit of the results of the management of its funds; • INVCO must have a limit on its authorized share-capital and each share must have a nominal share value; • Some restrictions: an INVCO can only have up to	• Internal management carried out similarly to public limited companies; • Directors must pass a 'fit and proper' test and be approved by the MFSA; • Annual reports must be filed, and accounts and directors' report must comply with both the Companies Act and the Investment Services Act.

	15% of its investments as holdings in other companies that are not other INVCOs; Distribution of an INVCO's capital profits is prohibited by its M&A, and it cannot retain more than 15% of income derived from securities.	
SICAV	• Form of company with a variable share capital equal to the net asset value of the company, and no nominal value assigned to the shares; • For collective investment or retirement scheme use; • May be registered as a private (SICAV Ltd.) or a public (SICAV p.l.c.) company; • Several different structuring options: - Multi-fund/ 'umbrella' company where different classes or groups of shares comprise sub-funds with distinct investment objectives and policies; - Possibility for each sub-fund to have a separate patrimony, thus allowing for the ring-fencing of assets & liabilities of each sub-fund; - Recognised Incorporated Cell Companies (RICC), where each Incorporated Cell (IC) is established as a separate collective investment scheme, with its own licence and separate legal & juridical personality. The RICC would provide standardised administrative services to its ICs in a 'platform' setup.	• Internal management carried out similarly to public or private companies, depending on whether the entity is a private investment company (SICAV Ltd) or a public investment company (SICAV p.l.c.); • Number of Directors and the criteria which they must fulfil varies, depending on the purpose for which the SICAV is being set up (e.g., an Alternative Investment Fund, a Professional Investor Fund, or an Undertaking for the Collective Investment in Transferable Securities (UCITS), and the category of investment licence which the SICAV obtains under the Investment Services Act; • Directors must pass a 'fit and proper' test and be approved by the MFSA. The Registry of Companies must be notified of changes in relation to the officers of the company; • Annual reports must be filed, and accounts and directors' report must comply with both the Companies Act and the Investment Services Act.
Trust	• A trust creates a fiduciary relationship between the trustee and the beneficiaries; • Property is transferred to trustee who has all the rights of a person having absolute title to property; • However, the rights of ownership of the trustee are limited by the duties they owe to the beneficiaries; • Malta is a signatory to the Hague Convention on the law applicable to trusts and therefore recognises trusts which are not Maltese trusts;	• Trustee must act with prudence, diligence, and utmost good faith and to administer the property as if it were his own; • Delegation of tasks by trustee is not allowed except in certain instances e.g., role of investment manager; • Other powers may also be allowed to trustee e.g., power to vary terms of the trust deed; • Trustee can resign or be removed by the Court. Once

	• **Separate patrimony** between property held trustee and other property of the settlor; • **Flexibility** when it comes to distribution amongst beneficiaries and ensures that the property is not divided but is administered as one, ensuring continuity across generations.	this occurs, ownership is transferred to the successor trustee.
Family Trust Company/ Private Trust Companies (PTC)	• Corporate version of the private, individual trustee- a company can be set up in order to act as trustee and manage a family's wealth and assets settled under trust; • It cannot be a company that holds itself out as providing trustee services or one which habitually acts as trustee; • Does not require MFSA authorisation but only registration in Register kept by the MFSA for that purpose.	• Family members can act as directors or exercise control through shareholder voting rights; • Change in trustee can be conducted by simply changing the directors; • Minimum of three directors: must be approved by MFSA as being fit and proper; • At least one of the directors must be a person who has experience in the administration of trusts.

2. Matters to be considered when choosing a particular type of business entity

The decision as to which one of the business entities should be opted for, depends largely on the circumstances. Maltese law does not prescribe that a certain type of business entity needs to be set up if circumstances subsist, although in the case of limited liability companies, certain variances would apply, if for instance, the company is a single member company. In making such a decision, certain considerations should always be made, most prominently, taxation, employment law, whether the entity is intended to provide a service and contractual requirements applicable under Maltese law.

3. Steps and timing to incorporate a company

As the limited liability company is the most common form of business entity used as a vehicle for entry in the Maltese market, main focus will be placed on the requirements that need to be fulfilled and timing involved in incorporating and registering the company. The process for registration of the company starts with the registration of the Memorandum and Articles of Association (M&A) to the Malta Business Registry (MBR). The responsibility for the adherence of the Articles of Association with the law, rests with the subscribers or the original shareholders of the company. The M&A must also be accompanied by proof of payment of the original subscribed share capital which takes the form of a bank slip, together with the payment of the registration fee due to the MBR and simple due diligence carried out on the first directors and shareholders if these are not already known to the MBR. The company is deemed to come into existence and is authorised to commence business as from the date of registration indicated on the stamp placed by the MBR on the M&A. This date is also indicated on the certificate of incorporation issued by the MBR and which is kept at the company's registered office. In practice, if all documents submitted are in order, the name of the company is available and the fees are paid, registration will take place with effect from the date of filing and will be registered on the MBR's online records, one to two days later. The registration number allocated to the company is usually available within hours.

4. Governance, Regulation & Maintenance

4.1 Corporate Governance

The aim being good corporate governance is to encourage the business structure to create value, such as through innovation or development, and provide accountability and control systems commensurate with the risks involved. Whilst Maltese law does not include a specific list of rules which should be followed, the Malta Financial Services Authority has issued guidelines for licensed entities, which can be used as guiding principles for limited liability companies.

The Companies Act sets out the obligations which partnerships en nom collective, partnerships en commandite, and limited liability companies (both public and private) must fulfil. SICAVs and INVCOs must adhere to the obligations as set out in the Companies Act, as well as the Investment Services Act and any other Maltese/EU law which governs investment services.

The governance of companies is carried out by their directors, who have duties of loyalty, care, diligence, and skill towards the entities they manage. Amongst the obligations they must fulfil are the duty to keep accounting records and submit accounts which are independently audited, an auditor's report and a directors' report annually. The annual accounts must be filed within 10 months from the end of the

financial year. The format of the accounts varies according to the size of the company. Companies which have subsidiaries must draw up consolidated financial statements for the group of companies. Another statutory obligation is the submission of an annual return to the MBR, which sets out the registered address, a summary of the changes in the share capital, a list of shareholders and the particulars of the directors and the company secretary.

4.2 Majority Rule and Minority Rights and Protection

In Malta, the principle of majority rule has been recognised as an essential feature of a limited liability company. The minority must, as a matter of necessity, accept the decisions of the majority or else attempt to reverse them through lobbying or other means. At the same time, this rule places the majority shareholder in a position of power which can give rise to abuse and in such instance, lobbying might not be an effective remedy for the minority shareholder. The Companies Act 1995 provides a remedy in cases where the affairs of the company or any act or omission of the company has been or is likely to be oppressive, unfairly discriminatory, or unfairly prejudicial to a member. Whilst the wording of the law does not limit the application of this remedy to minority shareholders, it is generally held that the intention of the legislator was to include this section in the law for the protection of the minority shareholder as the position of power allowed to majority shareholders already places the latter in an advantageous position. The Maltese courts then have wide discretionary powers as to the kind of remedy it can grant.

4.3 Maintenance and Regulation

The officers of companies must also inform the Malta Business Registry about changes occurring within the company, which is done by submitting statutory forms to the Malta Business Registry. These changes include the appointments and resignations of directors and company secretaries, share transfers, amendments to the constitutional documents of the company, a change in registered address, or issue of shares. An annual return must also be submitted to the MBR, providing a summary of the structure of the Company at a particular point in time. The annual return must be signed by the director or company secretary. As of the 30th of June 2018, the annual return must also be accompanied by a 'Beneficial Ownership Form', which provides information about the company's ultimate beneficial owner.

Issues relating to money laundering and the funding of terrorism are of utmost importance to the existence of a business entity, both a t incorporation stage and also as an ongoing obligation. In Malta, money laundering is criminalised primarily through the Prevention of Money Laundering Act which is supported by the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR). This Act also establishes the Financial Intelligence Analysis Unit, which is the regulator when it comes to AML and CFT issues. The FIAU has also issued implementing procedures which are meant to assist subject persons in fulfilling their obligations under the PMLFTR. However, these procedures are not mere guidelines are actually binding on all those subject to them. Persons incorporating a company in Malta are screened for anti-money laundering and the countering of funding of terrorism purposes. It is common that a person interested in setting up a Maltese company gets in touch with a company services provider (CSP), which agrees with the original subscribers of the company to set up the company for them. The services carried out by CSPs fall under the definition of 'relevant activity under the PMLFTR. As a subject person, the CSP will need to carry out

various checks before agreeing to set up the company, including verification of the client's identity , determining the source of wealth and source of funds of the proposed company's UBO, and identifying the AML and FT risks involved in entering into a business relationship with that person. Where the business relationship is of an ongoing nature, CSP are obliged to continue monitoring the level of risk throughout the duration of that relationship.

4.4 Tax and Reporting obligations

A company which is registered in Malta, but which is foreign owned, can benefit from an exemption from the duty to be paid on documents and transfers. Following incorporation, the company must apply to the Commissioner for Revenue in Malta, providing information about the company and asking the Commissioner to authorise the application of the exemption to that Company. The application of this exemption is also registered with the Malta Business Registry.

Malta's attractive corporate tax refund system is one of the advantages enjoyed when setting up a company in Malta. A company is considered to be tax resident in Malta when the management and control of the company is exercised in Malta. According to our income tax legislation, Maltese companies are subject to corporate tax at the rate of 35% on their worldwide income and capital gains. Foreign companies incorporated outside Malta carrying out business activities in Malta are liable to tax on income arising in Malta.

When companies are taxed at the standard rate of 35%, following the distribution of dividends, shareholders are entitled to a refund of the majority of the tax paid by the company. The purpose of this imputation system is to eliminate any double taxation that might arise on the distribution of such dividends. Thus, company profits will only be subject to tax at corporate level. This effectively means that a trading company can claim up to 30% tax refund, making for a net tax rate of 5. A structure can be set up specifically to benefit as much as possible from the efficient tax system in Malta. A Malta trading company pays the applicable 35% tax whilst the remaining 65% is paid as dividend to a Malta holding company. The Malta holding company will then receive $6/7^{th}$ refund of the tax paid by the trading company on distributed profits. At that point, no additional tax is due on transfers of profit to the foreign company or the foreign shareholders.

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INTERNATIONAL LAWYERS NETWORK

MARTÍNEZ, ALGABA, DE HARO & CURIEL, S.C.
MARTINEZ BERLANGA ABOGADOS, S.C.

ESTABLISHING A BUSINESS ENTITY IN MEXICO

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN MEXICO

Preface

Martínez, Algaba, De Haro y Curiel, S.C. ("MAHC"), and Martínez Berlanga Abogados, S.C. ("MBA") are law firms in Mexico with recognized trajectory, based in Mexico City, committed to provide the highest standard of professional legal counsel and representation.

MAHC was 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. MAHC 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, banking, regulatory, real estate, energy, and communications.

MBA, established in 2006, is comprised by professionals with high experience in general corporate, restructurings, corporate finance, mergers and acquisitions, joint-ventures, cross border transactions, real estate, local and cross border trust structures, and testamentary successions, as well as regulatory.

These combination of practice areas and fields of expertise allow our firms 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 2020, Mexico has a population of 126,014,024 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 2020 Report[42], Mexico stands in position 60 under the overall "ease of doing business" category, surpassing countries like Brazil (124), Colombia (67), India (63) and Costa Rica (74).

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,

[42] Last published report.

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 [43], the concept of single-shareholder corporations is not allowed under Mexican law.

A. Mexican General Law of Business Corporations (*LGSM*)

The LGSM regulates seven different types of business entities, of which six of them 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 types of entities, corporate practice has only left two of them as the most common choice used by domestic and 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 (*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.

[43] Simplified stock corporation (*sociedad por acciones simplificada*) ("SAS"), which is a recently created type of entity regulated pursuant to the LGSM, which 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 approximately $5.8 million Pesos (approximately $283,197.00 Dollars, as of October 2021).

(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 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 and an examiner (*comisario*).

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.

Shareholders representing thirty-three percent (33%) of the shares representing the capital stock are entitled to request the board of directors, or the sole administrator, or the examiner, to

summon a general shareholders' meeting to discuss the matters they request.

(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 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 – No Industrial 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. Unlike the SA, the SRL cannot

have industrial partners who contribute their personal work.[44]

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")[45].

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 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.

3. 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 amendments made to the LGSM published in the Federal Official Gazette (*Diario Oficial de la Federación*) on June 13, 2014). 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

[44] The SA may have the participation of industrial shareholders who contribute their personal work.

[45] The SAPIB and SAB are considered as "Public Companies" pursuant to the LMV.

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[46] to 250 million UDIS [47] (approximately $83,600,931.65[48] Dollars[49]), 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.

4. 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 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; 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

[46] "Pesos" legal currency of Mexico.
[47] "UDIS" Mexican investment units, equivalent to $6.956166 Pesos, as of October 2021.
[48] Exchange Rate of $20.8017 Pesos for $1.00 Dollar, as of October 2021.
[49] "Dollars" legal currency of US.

percent (10%) [50] 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[51] 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[52].

Shareholders representing ten percent (10%) of the shares representing the capital stock are entitled to request the board of directors, or the examiner, to summon a general shareholders' meeting to discuss about the matters on which they have voting right.

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 more of the capital stock of the SAPI[53].

(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[54], 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

[50] In such cases, the 25% established by the LGSM, would not be applicable.

[51] In such case, the percentage established in the LGSM is 25%.

[52] 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.

[53] In such case, the 25% established by article 201 of the LGSM, will not be applicable.

[54] Again, this is an exception to the provisions of the LGSM, which states an express prohibition for an SA to acquire its own shares.

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[55].

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* (authorized by local governments) or *Corredores Públicos* (authorized 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 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 3 – 5 business days), provided that there are words/names that require authorization from the competent authorities that regulate the activity related to the requested word/name (e.g., the use of the word "Investment" requires the authorization of the SHCP);
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

[55] The LGSM states that the SA shall publish their annual financial statements in the electronic system set forth by the SE per request of the shareholders.

stockholders 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 office of 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) and obtain the Digital Signature (*Firma Electrónica Avanzada*) ("FIEL") 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 – 7 business days); and

6. Filing and registration before other applicable Mexican authorities (such as the Foreign Investment Registry (*Registro Nacional de Inversión Extranjera*) ("RNIE"). Thereafter and during the participation of foreign investment in 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 five 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)[56], 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 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

[56] Except for the SAS.

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 authorized by the relevant court;

(c) The corporate purpose of the company, considering the foreign investment restrictions mentioned in the following Section VI;

(d) The amount of the capital stock of the Mexican company and the participation of each shareholder or partner in such capital stock, as well as the par value of the shares or the indication that the shares shall not have a par value amount;

(e) 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;

(f) 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

(g) The rules regarding the dissolution and liquidation of the company.[57]

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") the Public Faith Officers are required 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.

[57] Such dissolution and liquidation rules shall be consistent with the LGSM. Per amendments to the LGSM in 2018, it was created a simplified dissolution and liquidation procedure that reduces considerably the period and costs of liquidation and companies may apply them as long as they comply with certain requirements.

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"[58]. 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. Per recent amendments to the LGSM and the Mexican Federal Fiscal Code, the SA and the SRL will be bound to (i) publish a notice of any transfer of their capital stock or equity in the electronic system set forth by the SE, and (ii) file notice to SAT regarding any transfer of their capital stock or equity.

(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.

[58] As listed in Article 17 of the AML 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*) and the FIEL are 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 whereto 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 has been no amendments to the relevant laws 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" [59] provided in their by-laws, which include, among others, national transportation of passengers in Mexican territory; and (c) activities with specific regulation were foreign investment can participate only in the percentages establish by the LIE, such as national air transportation in which case a maximum forty-nine percent (49%)

[59] An express agreement or covenant forming part of the company's corporate by-laws and setting forth that such corporation shall not admit, directly or indirectly, foreign investors or corporations with foreigners' admission clause, as partners or stockholders.

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 also allowed.

Also, the LIE states activities that require 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, as such as the private education, public railway transportation, airports and ports services.

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:

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.[60]

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:

[60] Such quarterly and annually reports shall be filed before the RNIE only when the company exceeds the thresholds of operations with its foreign related parties stated in the dispositions issued by the National Foreign Investment Commission.

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: (i) 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 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.

Disclaimer

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We remain at your disposal in relation to questions regarding this note and in relation to your business and look forward to assisting you.

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ESTABLISHING A BUSINESS ENTITY IN THE NETHERLANDS

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN THE NETHERLANDS

INTRODUCTION

PlasBossinade Advocaten Notarissen is a Dutch full-service law firm based in Groningen and Rotterdam at which lawyers, civil law notaries and tax lawyers practice law in all commercial areas.

This contribution is a brief summary on establishing a business entity in the Netherlands. On request our specialists are ready to give more information.

TYPES OF BUSINESS ENTITIES

In the Netherlands, there is a distinction between entities which qualify as legal entities ('rechtspersonen') and partnerships ('personenvennootschappen') which do not.

Legal entities are subjects of law and as such have rights and obligations. The rights and obligations of partnerships are held by the persons or legal entities for whose account the partnership is carrying on its business activities.

Legal entities

The most common type of legal entities in the Netherlands is the limited liability company, named *besloten vennootschap* or B.V. for short. The other type of legal entities is the public company named *naamloze vennootschap* or N.V. for short. The B.V. and N.V. are in many aspects very similar.

> The Societas Europaea (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.

As of 2012 shares in a B.V. may be traded, that is on a stock exchange or otherwise. Formerly the transfer of shares in a B.V. was blocked by either pre-emption rights of other shareholders or mandatory approval by the board or another body within the B.V.

The minimum capital requirement of € 45.000,-- for the N.V. is a relevant distinction between the two types of companies. Per October 2012 the minimum capital requirements for the B.V. ended, making it possible to transfer shares freely and liberating the possibilities to contribute on shares and to distribute dividends.

As a result, since October 2012, it is relatively easy to establish a B.V. in the Netherlands and to trim it to one's specific needs.

We will now dive deeper into specific aspects regarding the B.V. and N.V. The following rules apply to both entities, unless stated otherwise.

Name

The incorporator is free in choosing a name, provided that in doing so it will not infringe on existing names or trademarks. The name is also the trade name under which the B.V. operates, with the letters 'B.V.' added. The B.V. may use more trade names and can file these at the Dutch trade registry. The addition 'B.V.' is reserved for the 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 needs to have a value of at least € 0,01, for the B.V., € 45,000 for the N.V. and € 120,000 for the S.E.

Types of shares

Ordinary shares have voting and dividend rights. Solely in the B.V. it is possible to have shares without voting rights. Other types of

shares are preferred shares, which have a preference over the profits and priority shares, which entitle the holder to a right of approval in respect of certain board or shareholder resolutions.

Obligations for shareholders

The articles of association of a B.V. may impose certain obligations on the holders of shares which go beyond paying for 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.

Transfer of shares

The transfer of shares requires a notarial deed, unless shares are listed on the stock exchange. The articles of association may contain a clause which provides 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 a B.V. and decides on all matters which are not within the competence of other bodies. As a result, the shareholders meeting decides on e.g.: establishing the annual accounts, amending the articles of association, appointment, and dismissal of managing directors and supervisory directors and winding up.

Ultimate beneficial owner

As of September 2020, it is required to list the natural person or persons which are the ultimate beneficial owner of a legal entity in the registry held by the Dutch Chamber of Commerce.

Board

The board consists of one or more directors. Their appointment and remuneration is decided on by the shareholders meeting. There are no restrictions on nationality or place of residence of directors. Nevertheless, as of July 2016 it is possible that a specific natural person is forbidden by the court to be a director. It is not required to appoint a natural person. Legal entities may also be appointed as director.

The company is represented by the board, each director, or two or more directors jointly. In principal representation is fully and unconditional but can be limited and/or conditional. One can for example elect the system that the company can only be represented by two directors jointly or by the full board, with a power of attorney attributed to one or more directors specifically prescribing their authority. In acting they will then act as proxy for the board, not as director.

Supervisory Board

The supervisory board is appointed and dismissed by the shareholders meeting and may consist of one or more members. The task of the supervisory board is to review the functioning of the director(s) and to advise them.

Since 2013 it is possible to create a one tier board formed by executive directors and non-executive directors. This is a concept which is not commonly used.

A supervisory board is optional unless the company has a certain size and therefore qualifies as a so-called *structuurvennootschap*. These companies are companies with an equity (issued and paid share capital plus reserves) of € 16 million, a works council and at least 100 employees working in the Netherlands. Their supervisory board needs to have at least three members.

At a *structuurvennootschap* some powers which are otherwise the domain of the shareholders meeting shift to the supervisory board, e.g., the appointment and dismissal of managing directors and the approval of certain board resolutions (amongst others: sizable mergers or acquisitions, amendment of the articles of association or winding up).

Shareholders' resolutions

Shareholders' resolutions are 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 to the dismissal of directors the required majority may not be more than two-thirds of the votes representing at least half of the issued share capital. Should the articles of association demand a larger majority or quorum, such provisions will be null and void.

Other legal entities

Other types of legal entities which are being used commercially are the cooperative named *coöperatie* and the mutual (insurance) company named *onderlinge waarborgmaatschappij*. Both are derived from another legal entity, the association, named *vereniging*.

The *coöperatie* traditionally is a form of agricultural organization where the members trade their produce with a central producing unit owned by the *coöperatie*. The *coöperatie* sells the end product 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 chosen by 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 also perform such activities 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 named *stichting*. A foundation is an entity in itself, governed by a board which, depending on the organizational statute, may have a supervisory body. The foundation does not issue shares nor membership rights and the equity of the foundation will be solely available to further the statutory objectives of the foundation. The statutory objectives may not consist of making distributions to its incorporators or third parties unless the third-party distributions have an idealistic or social purpose. Foundations are most commonly charities or institutions in the field of healthcare, social work, or culture.

Foundations can also serve as vehicle for undertaking commercial activities. Given the restrictions on making distributions such commercial activities mostly are in function of the idealistic objectives.

Another purpose for foundations is to serve as an instrument for separating share dividend rights from voting rights via so-called 'certification'. As a result of the certification of shares the voting rights attached will be exercised by the board and the dividend rights will accrue to certificates issued to third parties. In doing so the holders of the certificates will in fact own shares without voting rights. This practice is common in the Netherlands and

mainly used for structuring ownership of (family) businesses. One or more (family) members who are involved in the business will hold ordinary shares and the board position(s) in the foundation, whereas the other (family) members will hold the certificates with dividend rights.

> Since the creation of shares without voting rights in the B.V. other solutions are available to trim the right structure.

Certification of shares can also be used as a shield by N.V.'s listed on the stock exchange. In that case a sizeable part of the shares are held by a foundation and listed in the form of certificates. The voting rights attached to the shares are exercised by a board, which aims to protect the interests of the company.

Partnerships

The partnerships available in the Netherlands are listed hereunder. These entities are tax-transparent, meaning that tax is levied at the level of the partners, not at the level of the entity itself:

The Sole proprietorship named *eenmanszaak* strictly speaking this is not a partnership. An individual which is taking up a business and who acts in the course of that business without choosing a legal entity or partnership with other entrepreneurs, is acting as a sole proprietor. Rights and obligations of the business are of the individual as are any liabilities. Nevertheless, such an entrepreneur may have employees. Those employees are employed by the entrepreneur himself.

there are two types of partnerships: the *maatschap* and the *vennootschap onder firma*. The *maatschap* is intended for co-operating professionals, such as lawyers, dentists, doctors, architects, and accountants. The *vennootschap onder firma* or *v.o.f.* for short is intended for other business. Characteristic for both types is that the partners have contributed monies or goods and provide their (skilled) labour 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.

A special sub-type is the Limited Partnership called *commanditaire vennootschap* or *c.v.* for short. It is a partnership with one or more public partners and one or more so-called silent partners added. The silent partners contribute money or goods to the C.V. but are not known to the public and they may not perform acts on behalf of the C.V. They may participate in decision making. 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. Business is conducted on behalf of C.V. The revenue is split between all partners in a way determined by the deed of partnership. Losses are 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. Liability towards third parties will be triggered when a silent partner performs an act on behalf of the C.V. The extent of the liability is not a given but based on case law it is safe to assume liability will fully extent towards all creditors.

THE INCORPORATION PROCES

Legal entities

Articles of association

Legal entities are incorporated by notarial deed passed by a Dutch civil law notary. The notarial deed contains the articles of association, which

provide for the name, objective, number, and type of shares, authorized and paid in capital, number and authority of the directors and (optional) supervisory board and all other regulations concerning the governance and operation of the entity. Apart from the incorporation of a *coöperatie* or *onderlinge waarbormaatschappij*, all legal entities may be incorporated by a single incorporator.

Acts before incorporation

It should be noted that the effect of bringing rights and obligations within the shell of a legal entity will only be realized upon incorporation of the legal entity followed by filing the entity in the trade registry in the Netherlands.

Acts performed prior to incorporation or registration will only become acts of the entity once ratified by the board after the registration has taken place. If ratification does not take place, or is done prior to registration, the persons acting on behalf of the entity remain personally liable towards third parties.

For the N.V./B.V. such ratification, if done by the board whilst it knows or should have known that the N.V./B.V. will not be able to fully comply. personal liability of the persons who acted will revive and the board members who ratified the acts may also be held liable.

Incorporation step-by-step

The steps to be taken in the course of incorporating a legal entity are the following.

Step 1: a civil law notary will have to be instructed to make a draft deed of incorporation.

Step 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);

Step 3: in the deed of incorporation, the initial board member(s) and (if applicable) the first supervisory board member(s) will be appointed;

Step 4: for the N.V./B.V. the share capital needs to be paid in forthwith upon incorporation. For the N.V./B.V. contribution in kind is possible but a description of the goods and a valuation are required. For the N.V. additionally a statement of a certified public accountant which confirms the sufficient value of the contribution is required. These rules also apply acquisitions of goods which did belong to incorporators or shareholders by the N.V. in the period from incorporation until two years thereafter. This is called *Nachgründung*.

Step 5: the civil law notary will file the entity at the trade registry held by the chamber of commerce, in principle on the same day as the incorporation. An extract showing the entry can be obtained immediately afterwards.

The time it takes to follow these five steps for incorporate will largely consist of the time it takes to give the civil law notary the proper instructions and documentation. Incorporation and registration itself do not take more than a day.

Partnerships

Partnerships are 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 the partnership has 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.

GOVERNANCE AND ONGOING MAINTENANCE

Legal entities

Governance

Next to governance issues, which are previously mentioned, there is a noteworthy new law in effect per the 1st of July 2021 called *Wet bestuur en toezicht.* Following out of this new law governance of legal entities will become more like the B.V./N.V. structure by opening up the possibility of a one-tier board, by standardizing conflict of interest provisions and by expanding the liability of directors and members of the supervisory board.

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 following three criteria, it will be required to have the annual accounts audited by a certified public accountant. the requirement is (1) a turnover of more than EUR 8,800,000, (2) a balance sheet total of more than EUR 4,400,000 and (3) an 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 of a bankruptcy this non-compliance in the three years prior to the bankruptcy form a irrefutable presumption that the management acted improperly, and it is assumed that the improper performance 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.

Partnerships

Governance

With respect to governance issues, we refer to what is being written on the specifics of the partnerships above.

Maintenance

Pursuant to Dutch tax law, partnerships 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.

Partnerships need to file timely tax returns concerning all taxes, such as for instance wage tax, value added tax (VAT) and income tax.

TAX

Here a few issues regarding business tax will be reviewed, namely the participation exemption, thin capitalization and withholding tax.

Participation Exemption

A legal entity is subject to taxation. The aforementioned businesses which are not a separate legal entity are not subject to taxation, because they will mainly be transparent for tax purposes. Tax will be levied at the level of the (income of) partners of the partnership, not at the entity itself.

Foreign companies investing in a legal entity in the Netherlands will also be confronted with Dutch tax law. If transactions between affiliated companies take place (e.g., financing and delivery of goods or services) parties should trade at arm's length in order 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 has tax treaties with many countries. Furthermore, EU law and regulations may apply. Noteworthy are the Parent-Subsidiary Directive which prevents double taxation on the income of affiliated companies located in different EU member states and the Merger 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./B.V. – which is not an investment company – can apply a participation exemption for corporate income tax purposes. Profits, for example dividends and profits on the sale of a participating interest, that have been taxed at a subsidiary will not be taxed again at the parent company if this exemption applies.

Thin Capitalisation

Due to erosion of the tax base profit 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 entity in the Netherlands to foreign companies are not subject to Dutch withholding tax. A withholding tax called *Wet bronbelasting 2021* came into force on the 1st of January 2021 and applies to interest or royalty payments by a company established in the Netherlands to an affiliate in a low-tax jurisdiction and in abuse situations.

Dividends may be subject to Dutch dividend withholding tax. The Dutch withholding tax rate for dividend is 15%. As mentioned before: 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.

Fall 21

INTERNATIONAL LAWYERS NETWORK

ØKLAND & CO

ESTABLISHING A BUSINESS ENTITY IN NORWAY

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN NORWAY

1. 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 partnerships 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”.

2.5 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.

The 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. However, you need to have a Norwegian D-number and a Norwegian business address to establish and operate a business. 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 abovementioned 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, a lawyer, or an authorized accountant 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 12% for passenger transport. The same applies inter alia to hotels and other businesses that rent out rooms, apartments, and vacation homes to tourists. It should be noted that Norwegian authorities is currently implementing a “package” of measures in connection with the coronavirus situation. The package includes a temporary lowering of the VAT low rate (the 12% rate) to 6%, which is expected to be in force until 31 October 2020.

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 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 be 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 22%. 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 31,68% 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 22%. 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.

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The law firm Økland & Co DA is a full-service business law firm serving legal needs throughout Norway and internationally.

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.

Our services are performed in close collaboration with the client, and they are aimed towards the goal that appears to be the best in each particular case.

The law firm Økland & Co DA was established in 1983 and today we are 46 employees, of which 36 are attorneys/associates. We are located in Lillestrøm, Oslo, Eidsvoll and Sørumsand.

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INTERNATIONAL LAWYERS NETWORK

KAPUNAN & CASTILLO LAW OFFICES ESTABLISHING A BUSINESS ENTITY IN THE PHILIPPINES

ILN CORPORATE GROUP

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 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 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

Under the former *Corporation Code of the Philippines*, it was required that a domestic corporation be formed by at least five (5) original incorporators. With the advent of *Republic Act No. 11232,* otherwise known as the *Revised Corporation Code of the Philippines ("RCC")* [61] , this minimum requirement for incorporators was abolished. In fact, the *RCC* now allows the establishment of a *One-Person Corporation* ("OPC") composed of a single shareholder who may be a natural person, a trust, or an estate.

To establish a domestic corporation, 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

[61] The concerned government agencies have yet to issue the implementing rules and regulations for the RCC.

Exchange Commission. Depending on the nature of the business, certifications are also required from the concerned government agencies which regulate each particular industry. Apostillized 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 apostillized where the parent company is situated. The processing of the approval can take about two weeks from the submission of complete documentary requirements.

In addition, the *RCC* also now requires that within sixty (60) days from the issuance by the Securities and Exchange Commission of a license to transact business to a branch office of a foreign corporation, said branch must deposit acceptable securities to the SEC with an actual market value of at least P500,000.00 for the benefit of present and future creditors of the licensee.

3. Joint Venture Arrangement

In as much as the joint venture arrangement usually results in a new business entity, 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 apostillized documents coming from the foreign company based abroad. 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 if they exist under the laws of another country, and if 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 equivalent office of the Philippine Department of Trade and Industry office in the 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 equivalent office of the Philippine Department of Trade and Industry office in the 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 in such amount as may be necessary to cover its operations in the Philippines which shall not be less than 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.

With the introduction of the OPC, corporations no longer have a required minimum number of directors although the maximum is retained at fifteen (15) directors. 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. Relevantly, the *RCC* requires a domestic corporation who acts as a Resident Agent of a foreign corporation to be of sound financial standing and must show proof that it is in good standing as certified by the Securities and Exchange Commission.

With the enactment of the *RCC*, certain corporations classified as "corporations vested with public interest" are required to have independent directors constituting at least 20% of their board of directors and to appoint a compliance officer.

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

Industry	Allowed Foreign Equity
Mass Media, Except Recording	**None**
Practice of All Professions	**None**
Retail Trade, Paid-Up Capital of Less than US$2,500,000	**None**
Cooperatives	**None**
Private Security Agencies	**None**
Small-scale Mining	**None**
Utilization of Marine Resources in Philippine Waters, Including the Exclusive Economic Zone	**None**
Ownership, Operation and Management of Cockpits	**None**
Nuclear Weapons Trade and Manufacture	**None**
Biological, Chemical and Radiological Weapons and Anti-Personnel Mines Trade and Manufacture	**None**
Manufacture of Firecrackers and Pyrotechnics	**None**
Private Recruitment for Local or Overseas Employment	**Up to 25%**
Contracts for the Construction of Defense-related Structures	**Up to 25%**
Advertising	**Up to 30%**
Contracts for the construction and repair of locally funded public works, except infrastructure/development projects and projects which are foreign-funded or assisted and required to undergo international competitive bidding	**Up to 40%**
Exploration, Development, and Utilization of Natural Resources	**Up to 40%**
Ownership of Private Lands	**Up to 40%**
Public Utilities	**Up to 40%**
Ownership, Establishment, and Administration of Schools	**Up to 40%**
Culture, Production, Milling, Processing, and Trading, Except Retailing, of Rice and Corn, and Acquiring Rice and Corn and the Rice and Corn By-Products	**Up to 40%**
Contracts for the supply of Materials and Goods to Government-owned or Controlled Corporations, Companies, Agencies, or Municipal Corporations	**Up to 40%**

Operation of Deep-Sea Commercial Fishing Vessels	**Up to 40%**
Private radio communications network	**Up to 40%**

LIST B

Foreign Ownership is Limited by Reasons of Security, Defense, Risk to Health and Morals, and Protection of Small and Medium Enterprises

Industry	Allowed Foreign Equity
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)	**Up to 40%**
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)	**Up to 40%**
Manufacture and Distribution of Dangerous Drugs	**Up to 40%**
Sauna and Steam Bathhouses, Massage Clinics, and Other Like Activities	**Up to 40%**
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.

In addition, within six (6) months after the fiscal year of a licensed branch office of a foreign corporation, the Securities and Exchange Commission may require the said branch office to deposit additional securities or financial instruments equivalent in market value to 2% of the amount by which the licensee's gross income exceeds P10,000,000.00.

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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ESTABLISHING A BUSINESS ENTITY IN PORTUGAL

ILN CORPORATE GROUP

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ESTABLISHING A BUSINESS ENTITY IN PORTUGAL

I. INTRODUCTION

Portugal has circa 10,3 million resident inhabitants and most of its population lives in sunny coastal areas. Important cities include the capital 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 the 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 legal regime ("*Regime jurídico do Registo Nacional de Pessoas Coletivas*").

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 ações*").

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 (Euronext Lisbon, PSI-20 or "*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/titles (depending on whether they are represented by registrations in an account or by paper documents).

Along with the shares with par or nominal value, it is also possible to issue shares without par value, in order 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 ("*ações 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 ("*ações 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 ("*ações 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 1% 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 also have 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 ("*ações 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 call for 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.

As a general rule, a PLC is allowed to acquire and hold its own shares up to a maximum of 10 % of its total registered share capital (in certain cases provided by law this amount may be exceeded). The voting and economic rights inherent to these shares are suspended as long as 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 (Euronext Lisbon, PSI-20 or "*Bolsa de Valores de Lisboa*").

In an 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.

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.

As a general rule, 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) an 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 no. 495/88, of December 30, 1988, as amended.

A holding company must be organized either as a PLC ("S.A.") or as an 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 various 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 is allowed to 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 ("*ASF*", former "*Instituto de Seguros de Portugal*"). Others are subject to the supervision of the Tax Authority ("*Inspeção-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 (statutory auditor) or an audit company (statutory 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 no. 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 Commercial Registry Office. 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 why 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 in order to be eligible to be registered with Tax Authorities.

Since the last reform of the Companies Code (2006), and as a general rule, 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 (statutory auditor), whose report must be referred to in the incorporation deed.

Afterwards, company's deed of incorporation must be registered with the Commercial Registry Office ("*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 Commercial Registry Office (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 internet) 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 required to have any insurance policies as a consequence of incorporation. 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.

The 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*"), and that 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 executivo*"), a general and supervisory board ("*conselho geral*

e de supervisão"), as well as a certified chartered accountant (statutory auditor). In addition, a PLC whose shares are listed on stock exchange market must appoint a secretary ("*secretário*") and the respective alternate.

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 of directors.

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 upon at least 1 month or sent 21 days in advance as to the date of the general meeting, and shall mention, amongst other information, the 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.

It is also possible to hold 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, to approve valid resolutions, a minimum presence of voting share capital for shareholders may be required - 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.

Most 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.

On 21 August 2018, the Portuguese Government published Ordinance 233/2018 that regulates certain aspects of the legal regime of the Beneficial Owner Central Registry ("BOCR") (approved by Law 89/2017, of 21 August 2017). The Portuguese BOCR ("*Registo Central do Beneficiário Efectivo*") legal regime transposed Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing into domestic law and has an impact on all managers, shareholders and companies based on the beneficial owner disclosure rules. The BOCR is composed of a database managed and maintained by the Institute of Registry and Notary ("*IRN – Instituto dos Registos e Notariado*") which contains the identification and information about the natural persons who, directly or indirectly, have ownership or effective control of established entities in Portugal, in order to enhance transparency in business relationships and compliance with the disclosure obligations for the prevention and combat of money laundering and terrorist financing.

After the incorporation of a new company, it is mandatory to submit a beneficial owner declaration, which should contain information regarding the disclosing entity, shareholders, directors/managers, and beneficial owners (which, being a broad legal definition, must be subject to confirmation on a case-by-case basis). This register must be updated when there are relevant changes, and it is also subject to annual validation.

In addition to such obligations, the company must also produce and keep an updated internal record with the identification of the direct shareholders and all individuals who, directly or indirectly, own shares/interests and/or have the effective control of the disclosing company.

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 specific 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.

There is a special regime for commercial establishments, services, and restaurants. These regulations are set out in Decree-Law 10/2015, of January 16 that regulates the legal regime of the Access and Exercise of Commercial activities, services, and restaurants.

This regime, implemented 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 commercial establishments, services, and restaurants.

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.

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 esplanade, 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 exploitation of an establishment included in the list present in the article 4th of the Decree-Law 10/2015 is now only subject to a prior notification addressed to the "DGAE - *Direção-Geral das Actividades Económicas* (Directorate-General for Economic Activities). With this prior notice and payment of the fees due, the owner is immediately allowed to open and operate the establishment, exploit the warehouse, or begin its activity, as applicable. With regard to operating hours, owners must send a prior notification authorization to "*balcão do empreendedor*", 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 or the nearest "DRE – *Direção Regional do Ministério da Economia e da Inovação*" (regional office of the Ministry of the Economy and Innovation) or with the relevant Trade Association.

Despite the freedom of access granted to the activities mentioned in the Decree-Law, companies must comply with the requirements established in other regimes, such as:

(i) the legal regime for construction in urban sites, as set out in Decree-Law 136/2014, of September 09, 2014, as amended;

(ii) the legal regime for waste management, regulated by the Decree-Law 178/2006, of September 5;

(iii) the legal regime for prevention and control of emissions of pollutants into the atmosphere, set forth in the Decree-Law 38/2018, of June 11;

(iv) the legal regime for evaluation of the environmental impact of public and private projects susceptible of causing significant effects on the environment, regulated by the Decree-Law 152-B/2017, of December 11.

Furthermore, the installation and operation of these establishments must comply with the requirements set forth in specific laws, depending on the products traded.

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 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 and 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.

Once Portugal is a member state of the European Union, an entrepreneur planning to invest in the country is not submitted to stricter rules than 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 capitalization 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 is 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

PETERKA & PARTNERS
ESTABLISHING A BUSINESS ENTITY IN ROMANIA

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN ROMANIA

1. Types of Business Entities

When entering the Romanian market, foreign investors have the option of incorporating a new legal entity with a Romanian legal personality, or setting up a unit of a foreign mother company, which will not have a Romanian legal personality:

- Under Romanian law, companies with a Romanian legal personality may have the following forms:
- Limited liability companies (*societati cu raspundere limitata*)
- Joint stock companies (*societati pe actiuni*)
- Limited partnerships (*societati in comandita simpla)*
- Limited partnership by shares (*societati in comandita pe actiuni*)
- Partnerships (*societatea in nume colectiv*)

Foreign investors also have the option of incorporating a European company (*Societas Europaea*), with its headquarters in Romania.

The most common types of companies under Romanian law are limited liability companies (*societati cu raspundere limitata*) and joint stock companies (*societati pe actiuni*)

Foreign mother companies may establish units without a legal personality in Romania, such as:

- Branches (*sucursale*);
- Representative offices (*reprezentante*).

1.2. Limited liability companies

Limited liability companies (LLCs) are one of the most commonly used corporate forms under Romanian law. LLCs are founded by the signing of a constitutive act by the shareholder(s). Shareholders in limited liability companies may be foreign or Romanian individuals or legal entities and their number cannot exceed 50. The sole shareholder can have in its turn as sole shareholder a limited liability company, while one person maybe sole shareholder in more than one limited liability company.

It should be noted that in limited liability companies with sole shareholders, the sole shareholder – natural person may simultaneously act as shareholder, director, and employee of the company.

The contributions of the shareholders to the share capital of limited liability companies may consist of cash and contributions in kind (movable or immovable assets); there is no minimum share capital required, however, it is recommended that at least RON 1 per shareholder be submitted. Shares in limited liability companies cannot consist of freely negotiable bonds. The share capital must be paid entirely upon the incorporation of the limited liability company.

The liability of the shareholders is up to their participation in the share capital of the limited liability company.

The purpose of business of a Romanian LLC acting as subsidiary of a foreign mother company may be larger than or different from that of the mother company.

The duration of the LLC may be undetermined.

1.3. Joint stock companies

Joint-stock companies must have at least two shareholders, either natural persons or legal entities, Romanian or foreign.

The company may be dissolved should the number of shareholders become fewer than two, and should no regularization be implemented within nine months. A joint-stock company shall not be dissolved if the number of shareholders is re-established up until the

moment when the resolution of the competent courts becomes definitive.

The minimum share capital for a joint-stock company is RON 90,000. In addition, every two years, the Government may modify this amount, taking into consideration the exchange rate, in order for the said amount to represent the equivalent in RON of EUR 25,000.

Some of the contributions to the share capital of joint-stock companies must necessarily be made in cash, but the relevant legislation does not set forth a minimum. Contributions in kind may be made, but contributions to capital by way of provision of services are not accepted. Contributions by way of assignment of claims are admitted, except for joint-stock companies which proceed to public offerings.

The law requires at least 30% of the share capital to be paid up upon incorporation, but a distinction is set as to the payment terms of the balance of share capital depending on the nature of share capital contributions, as follows:

a) in the case of shares issued in exchange for contributions in cash, the balance of the share capital shall be paid within 12 months as of the company's registration;
b) in the case of shares issued in exchange for contributions in kind, the balance of the share capital shall be paid within a maximum of two years as of the company's registration.

The share capital is divided into shares having a par value of RON 0.1.

Shares, which can be either registered or bearer shares, have an equal par value and confer equal rights on shareholders, except for non-voting preference shares. Preference shares cannot represent more than one quarter of the share capital and shall have the same par value as ordinary shares.

A joint-stock company can hold up to 10% of its subscribed share capital during a period of up to 18 months. Those shares however do not entitle it to participate in the distribution of dividends, and the voting rights thereto are suspended.

The duration of the joint stock company may be undetermined.

1.4. Branches

Branches lack a legal personality of their own, being economically and legally dependant on the parent company. They have their own registered seat and conduct business operations on behalf of the parent company, on the basis of a mandate granted by the latter, but they may also conclude transactions on their own behalf. Branches must be registered with the trade registry from the country in which they will operate, upon the corporate decision of the mother company. No constitutive act is necessary, due to the lack of legal personality; however, the mother company must establish a head of the branch by its corporate decision.

There are no requirements with regard to any "endowment capital" in the case of a branch; in addition, there is a restriction as to the business purpose of a branch set up in Romania, which must have the same business purpose as that of the foreign parent company, or a part of the activities thereof.

The duration of a branch cannot exceed the duration of the mother company, as sustained by the relevant corporate documents of the latter.

1.5. Representative offices

Representative offices lack legal personality and act on behalf of the parent company,

lacking a patrimony of their own. Their registration is subject to authorization by the Ministry for Business Environment, Commerce and Entrepreneurship, upon the corporate decision of the mother company, and the establishing of a head of the representative office, on the basis of a power-of-attorney.

Representative offices may be set-up and perform their activity in Romania subject to a yearly functioning tax of USD 1,200. The duration of the representative office in Romania can by no means exceed the duration of the foreign mother company and it is granted in accordance with the taxes that are paid proportionally with the envisaged duration.

The only activities that a representative office may carry out are covered by the business purpose of the mother company, specifically: issuing/receiving offers and orders, negotiating, but not concluding contracts on behalf of the mother company (without a special mandate from the latter), undertaking marketing and advertising activities, carrying out any other ancillary or preparatory activities, promoting and/or supporting the business of the mother company.

2. Steps and Timing to Establish

2.1. Incorporation of entities with a Romanian legal personality

Irrespective of the corporate form chosen (limited liability company or joint stock company), the following formalities need to be complied with in order to set up a joint-stock company:

- reserving the corporate name at the Trade Registry (which is granted instantly, either online or in hard copy);
- drafting the constitutive act;
- deposit of the share capital;
- signature of the constitutive act;
- registration with the Trade Registry;
- incorporation;
- issuing of an incorporation certificate which shall mention the assigned Trade Registry number and the sole registration code.

The incorporation and the granting of the certificate regarding the authorization of the activities declared by the company shall be effective within three days from the date the application was filed with the Trade Registry if the complete required documentation is submitted.

The company is a legal entity from the date of its incorporation in the Trade Registry.

Joint-stock companies can be set up as closely held companies or by way of public offering. Specific formalities are required to set up joint-stock companies by way of public offering.

The subscription of shares shall be made in one or several copies of the issue prospectus.

The company can be set up only if the full share capital was subscribed and each subscriber has paid in cash half of the subscribed shares value. The other half shall be paid within 12 months from the incorporation date.

The constitutive meeting will have to verify the existence of the payments, to approve the constitutive act and to appoint the members of the Board of Directors or of the Supervisory Board, as well as the auditors.

Subject to the provisions regarding the issue prospectus formalities, the development of the constitutive act of a joint-stock company set up by way of public offering is no different from the one of a closely held joint-stock company, described above.

Companies set up by way of public offerings have to observe the capital market specific regulations.

2.2. Setting up a branch in Romania

In order to set up a branch of a foreign legal entity in Romania, no corporate name reservation from the Romanian Trade Registry and no constitutive act of the branch are necessary. The decision of the corporate body of the foreign legal entity competent to set up secondary units, according to the relevant foreign legislation or the constitutive act, the power-of-attorney granted to the head of the branch, together with relevant documentation, are submitted to the Trade Registry.

The registration of the branch is granted within three business days as of the submission of the full documentation.

2.3. Setting up a representative office in Romania

The setting up of representative offices in Romania is performed by registration with the Ministry for Business Environment, Commerce and Entrepreneurship.

A standard request which will contain information regarding the registered seat, the business purpose of the representative office, its duration, the number, and positions of the persons envisaged to be hired by the representative office and the power of attorney granted to the person mandated to represent the company in Romania, together with other documents are submitted to the Ministry for Business Environment, Commerce and Entrepreneurship.

The functioning authorization is issued within 30 days as of the day the relevant complete documentation is submitted.

3. Governance, regulation, and ongoing maintenance

3.1. Corporate governance

As previously mentioned, the most widely used corporate forms in Romania are limited liability companies and joint stock companies.

3.1.1. Limited liability companies

The mandatory corporate bodies of a Romanian LLC are the general meeting of the shareholders (GMS) and one or more directors, which may be organized into a board of directors

Decisions of a GMS in an LLC are passed by complying with the rule of double majority: (a) absolute majority of the number of the shareholders and (b) absolute majority of the shares. However, these requirements do not have a mandatory nature, and they may be obliterated by the provisions of the articles of association. Each share gives right to a vote.

However, for GMS decisions that pertain to the amendment of the constitutive act of the LLC, the unanimous vote of the shareholders is required, unless the law or the constitutive act provide otherwise. The transfer of shares to third parties must be approved by at least three-quarters of the share capital.

Directors in LLCs are appointed by the shareholders (either through the initial constitutive act or by a subsequent decision of the general meeting of the shareholders), for a limited term, either with full powers to represent the company, or with joint powers with other directors and/or other mandated persons. LLCs can have one director, and in case of plurality, the directors may be constituted into a board of directors, while the constitutive act may provide for special rules with regard to the adoption of decisions therein.

The revocation of the directors of an LLC is performed: (i) by the vote of all shareholders, if they have been appointed by the constitutive act, or (b) by the absolute majority of the share capital, if they have been appointed by a subsequent GMS decision, unless the constitutive act requires otherwise.

3.1.2. Joint stock companies

The general meeting of the shareholders (GMS) is a mandatory corporate body for all joint stock companies, whereas its management differs according to the distinction between the unitary and dualist management system.

GMS are ordinary ("OGM") or extraordinary ("EGM"), based on the issue with which they deal.

The quorum and majority rules in relation with the OGM are as follows:

a) For the first call, shareholders holding at least one-quarter of the aggregate number of voting rights must attend the meeting and the decisions must be adopted by the majority of the votes cast. However, the constitutive act may provide for a higher quorum and majority requirements;
b) For the second call, there are no quorum requirements, and the decisions must be adopted by the majority of the votes cast. The constitutive act may not provide for a minimum quorum or higher majority rules.

The quorum and majority rules within an EGM are as follows, unless the constitutive act provides for a higher quorum or majority rules:

a) For the first call, shareholders holding at least one-quarter of the aggregate number of voting rights must attend the meeting and the decision must be adopted with the majority of the votes of the attending or represented shareholders;
b) For further calls, shareholders representing at least one-fifth of the aggregate number of voting rights must attend the meeting and the decision must be adopted with the vote of the majority of the votes of the attending or represented shareholders.

Exceptionally, decisions having as their object (i) a change in the company's main purpose of business, (ii) a decrease or increase of the share capital, (iii) a change of the legal form, (iv) the merger, the division, or the dissolution of the company, must be adopted by a majority of at least two-thirds of the voting rights of the attending or represented shareholders. The constitutive act may stipulate a higher quorum or majority rules.

As for the administration of joint stock companies, the unified system means the administration of the joint-stock company is carried out either by a sole Director or by several Directors members of a Board of Directors. The Directors are appointed and revoked by the General Meeting of Shareholders (the "GMS") at any time, by secret vote. Nevertheless, in case of abusive revocation, the Director has the right to obtain recovery of damages.

In the dualist system, the administration of the joint-stock company is carried out by a Management Board (*Directorat*) and Supervisory Board. The Management Board (*Directorat*) is constituted by one or several members, their number always being odd. When the Management Board (*Directorat*) is composed of one member, such member is appointed as Sole General Manager.

The Supervisory Board appoints the members of the Management Board (*Directorat*), one of whom will be the President of the Management

Board (*Directorat*). The members of the Management Board (*Directorat*) may not be at the same time members of the Supervisory Board or employees of the company.

The members of the Supervisory Board are appointed by the GMS, with the exception of the first members, which are appointed in the constitutive act. The Supervisory Board is comprised of between three and eleven members. The members of the Supervisory Board may be revoked at any time by the GMS by a resolution adopted by a majority of at least two-thirds of the votes of the attending shareholders. The members of the Supervisory Board may not be members of the Management Board (*Directorat*) or employees of the company.

3.2. Reporting requirements

Romanian legal entities are required to submit annual financial statements to the Ministry of Finance within 150 days after the closing of the financial year. The format of the financial statements to be submitted (i.e., either extended or simplified) depends on the category of entity (micro-entities/small entities/medium and large entities) which is established based on key indicators from the financial statements of the previous financial year. Branches and other sub-units of a non-resident legal entity residing in the EEA are not required to submit annual financial statements; however, they are required to submit some financial reports within 150 days after the closing of the financial year.

Financial statements of medium and large entities are subject to statutory financial audit. Also, entities that meet at least two out of the following criteria for two consecutive years are also subject to financial audit: (i) total assets: RON 16 million; (ii) turnover: RON 32 million; (iii) average number of employees: 50.

3.3. Requirements for local shareholdings/directors

For shareholders, directors may be either natural persons or legal entities and there are no requirements in respect of their nationality.

Furthermore, persons who, according to the law, do not have legal capacity, or have been convicted of certain crimes (such as fraudulent management, breach of trust, forgery, use of forgeries, embezzlement, bribery, transgressions of the legislation concerning money-laundering), cannot be founders, shareholders, directors, or members of the board.

Companies that are in the performance of their function in a Romanian company's corporate body must be represented by an authorized individual representative who must fulfil the abovementioned requirements as well.

3.4. Protection of minority shareholders

The issue of minority shareholders is especially posited in the case of joint stock companies, given that in the case of LLCs, the general rule of double majority provides for sufficient protection.

For example, shareholders holding separately or collectively at least 5% of the JSC's share capital may introduce on the agenda of the shareholders' meeting new items; they may ask the board of directors or the statutory director to summon an extraordinary general meeting to discuss issues proposed by them.

If the articles of association provide for a percentage lower than 5%, then the articles of association shall apply.

4. Foreign Investment, Anti-Avoidance rules, Residency and Material Visa Restrictions

4.1 Anti-avoidance rules

Under the current provisions, "the excess debt cost" is defined as the difference between the

debt costs incurred and the interest revenues and other assimilated revenues incurred by the limited liability company/branch. The excess debt costs are deductible within a threshold of EUR 1,000,000/year.

The excess debt costs above this EUR 1,000,000 threshold may benefit from an extra deduction limited to 30% of the accounting profit adjusted downwards with the non-taxable revenues and upwards with the corporate income tax expenses, the excess debt costs, and deductible tax depreciation. If the base computed as described before is zero or negative, the excess debt costs are non-deductible in the current period, but they can be carried forward for an unlimited period of time and they can be deducted in the next periods applying the same mechanism as described.

4.2 Related-parties' transactions

According to Romanian transfer pricing (TP) legislation which mainly follows the OECD TP Guidelines, transactions carried out with related parties (including also Romanian related parties) shall reflect the arm's length principle. Otherwise, if the tax authorities were to consider that intercompany transactions do not reflect the market prices, they would adjust the corporate income tax position of the taxpayer. The adjustment will lead to additional corporate income tax liabilities along with late payment interest and penalties (0.03% per day).

According to the current rules, large taxpayers carrying out intercompany transactions that exceed certain thresholds are required to prepare the transfer pricing file by 25 March of the next year and to make it available to the tax authorities, within 10 days after a written request. Taxpayers not exceeding the abovementioned thresholds, as well as medium-sized and small taxpayers are also required to prepare transfer pricing files, but under less time pressure and only for tax audits. For them, TP files must be submitted within 30 days (the deadline may be extended up to 90 days) upon a written request from the authorities. Masterfiles drafted at the group level are not accepted and will not replace the local transfer pricing documentation.

4.3 Permanent establishment

According to the Romanian Fiscal Code, a permanent establishment (PE) represents the "place through which the activity of a non-resident is carried out directly or through a dependent agent". More specifically, a PE includes a place of management, branch, office, factory, shop, workshop, as well as a mine, oil, or gas well, quarry or other place of extraction of natural resources. A permanent establishment includes also a building site or construction or installation project or any related supervisory activity only if it lasts more than six months. Double Tax Treaties may provide for different time rules for the creation of a permanent establishment.

Since a PE means a taxable presence of a non-resident in Romania (i.e., with no legal presence), the PE shall register with the tax authorities as a corporate taxpayer prior to engaging in income generating activities. Alternatively, the PE could take the form of a branch, which needs to be registered with the Romanian Trade Registry. Repatriation of profits to the non-resident does not fall into the category of dividend payments and it is not subject to Romanian withholding tax.

Permanent establishments are required to compute, declare, and pay 16% corporate income tax. Depending on the tax avoidance method provided by the applicable double tax treaty, the profits earned in Romania will be either disregarded in the country of the "parent" company or the tax paid in Romania will be credited against the tax liability arising in that other country, according to the payment

certificate issued by the Romanian tax authorities.

4.4 Withholding taxes

According to the Romanian Fiscal Code, withholding tax is levied on certain revenues earned by non-residents from Romania, as follows: dividends, interest, commission fees, royalties, management/consulting services irrespective of the place of rendering, service fees related to services performed in Romania (excluding international transport services), gambling revenues, etc.

The withholding tax rates applicable in Romania are: (i) 5% for distributed dividend (ii) 10% for interest, royalties, commission fees, management and consulting fees (irrespective of the place where the services are actually rendered), service fees related to services performed in Romania, liquidation proceeds; (iii) 1% for gambling revenues (in the case of revenues up to RON 66,750); (iv) 50% for revenues paid to a bank account of a state with which Romania has not concluded an information exchange instrument if such revenues are generated by way of an artificial transaction.

Reduced withholding tax rates are applicable under the existing double tax treaties. The provisions of the double tax treaties are applicable upon the presentation of a valid tax residency certificate issued by the tax authorities of the residence country of the income recipient. Corporate tax exemptions may also be applied as long as the conditions set by the *EU Parent-Subsidiary* and *Interest-Royalty* Directive are fulfilled.

4.5 Avoidance of double taxation

Romania has concluded and signed approximatively 90 double tax treaties providing tax relief either based on the tax credit mechanism or the exemption mechanism.

As previously mentioned, according to Romanian tax law, the provisions of the double tax treaty become active as long as the income recipient provides the income payer with the valid tax residency certificate issued by the residence country tax authorities.

4.6 Harmonization with EU tax legislation

The European Directives in the area of direct taxes have been transposed into Romanian domestic legislation as follows:

- According to the EU Parent-Subsidiary Directive, a 0% withholding tax applies in Romania on dividends to be paid to an EU recipient (legal entity, profit taxpayer), provided that the recipient has continuously held at least 10% of the shares in the dividend paying company for at least 1 year (uninterrupted).
- According to the EU Interest and Royalties Directive, interest/royalty payments to be made by a Romanian income payer to an EU recipient (legal entity, profit taxpayer) would be exempt from Romanian withholding tax provided that the non-resident has held at least 25% of the shares in the Romanian company for an un-interrupted period of at least two years. Certain conditions should also be fulfilled in order for the tax exemption to apply (e.g., the loans should not qualify as hybrid or profit participating loans).

The provisions of the EU Directives transposed into the Romanian legislation will apply so long as the income recipient provides a valid tax residency certificate and a sworn statement attesting the fulfilment of conditions.

4.7 Further corporate tax exemptions

In the area of corporate income tax, the following tax incentives are available:

- Holding related tax incentives:
  - Dividends received from a non-EU corporate income taxpayer are non-taxable, as long as there is a double tax treaty concluded between Romania and the respective non-EU country and certain conditions are fulfilled (i.e., the Romanian taxpayer has held at least 10% of the share capital of the non-EU taxpayer for an uninterrupted 1-year period);
  - Revenues derived from the disposal of shares held in a Romanian legal entity or in an entity residing in a state with which Romania has concluded a double tax treaty are non-taxable, as long as the income recipient has held at least 10% of the share capital of the non-EU taxpayer for an uninterrupted one-year period.
- Tax exemption on reinvested profit – Companies which reinvest their profits in new technical equipment, computers, invoicing machines, software (including the right of use) used for business purposes may apply the tax exemption on the reinvested profit. There are specific conditions that must be fulfilled as far as the duration of use of such equipment subject to reinvested profit is concerned.
- Profit tax exemption applicable to taxpayers which exclusively carry out innovation and R&D activities during the first ten years of activity.

The abovementioned tax incentives are available only for corporate income taxpayers and not for taxpayers applying the microenterprise tax regime. In Romania, in the area of corporate tax, there are two applicable regimes: the standard corporate income tax regime and the microenterprise tax regime. According to the standard corporate income tax regime, the taxable profit is computed based on the following formula: total revenues – (ii) non-taxable revenues – (iii) total expenses + (iv) non-deductible expenses. Companies reporting a turnover lower than EUR 1,000,000 at 31 December are required to shift to the microenterprise tax regime (i.e., the turnover tax rate depending on the number of employees; 1% for the minimum of one employee, 3% for no employees). Once the threshold is exceeded, the taxpayer is required to switch to the standard corporate income tax regime. The microenterprise tax regime is the default regime at incorporation. However, the taxpayer may choose to apply beginning the standard regime when the following conditions are fulfilled: a share capital of a minimum of RON 45,000 and a minimum of two employees.

4.8 Residency and visas

The majority of immigration regulations are contained in: Emergency Ordinance no. 102/2005, Emergency Ordinance no. 194/2002, Regulation (EU) No. 492/2011 on the freedom of the movement of workers within the Union 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 are as follows:

4.8.1 Residency of EU nationals, citizens of European Economic Area member states and citizens of the Swiss Confederation

EU nationals, citizens of European Economic Area member states and citizens of Switzerland

(hereafter "Nationals") have in principle free access to the labour market of Romania, under the same conditions as Romanian nationals and to economic activities under the law applicable to Romanian citizens.

The entry of Nationals into Romania is visa-free and is admitted exclusively on the basis of a national identity document, a passport or of another valid travel document. Concurrently, Nationals can leave Romania by producing the same documents as those presented upon their entry.

The exit of Nationals from Romania can only be denied in two cases: (i) they are defendants in criminal cases and a preventive measure has been taken against them in compliance with the provisions of the Romanian criminal procedural code and (ii) they are criminally convicted, and detention must be executed. The stay of Nationals in Romania for fewer than three months is not conditioned by any other supplementary requirement.

The right of Nationals to temporary stay in Romania for a period exceeding three months is dependent upon several conditions: (i) they are workers, or (ii) they are able to support themselves and the members of their families and they possess health insurance acknowledged by the Romanian social security system or (iii) they are registered as students in an accredited educational institution in Romania, they have health insurance and they have the means to support themselves and their family members in Romania, usually at least at the level of the minimum guaranteed revenue in Romania or (iv) they are the family members of a National who complies with one of the abovementioned conditions. Nationals who are in one of the abovementioned situations apply for a registration certificate within three months as of their entry into Romania to the corresponding territorial branch of the Immigration Office, providing in their application supporting documents as to their compliance with the abovementioned conditions.

The above-mentioned are general rules provided for by Romanian legislation, that have not been amended during the COVID-19 pandemic. However, during the pandemic there have been and still there are restrictions as to the entry of Nationals to Romania, which may change on a weekly basis.

4.8.2 Third-country nationals

As per the provisions of Emergency Ordinance 194/2002, an "alien" is defined as any individual with neither Romanian citizenship nor the citizenship of any Member State of the European Union, of the European Economic Area or of the Swiss Confederation.

As a general provision, an alien can enter Romania only on the basis of (i) a passport or any other valid travel document for crossing the Romanian state border, (ii) visa, residence permit or residence card, as well as (iii) documents attesting to the purpose and conditions of the trip, and any documents indicating that they hold the appropriate financial means to support themselves during the transit.

The list of the countries whose citizens, holders of simple travel documents, must be in possession of a visa upon entry on the Romanian territory, as well as the list of the countries whose citizens, holders of simple passports, are exempt from the requirement of a Romanian visa, are established according to European Council Regulation number 539/2001, as well as according to the provisions of relevant international agreements to which Romania is party.

Long-stay visas will be issued to foreigners, on demand, for a period of up to 90 (ninety) days,

depending on the nature of the activity the applicant for such visa will carry out on the Romanian territory.

Aliens requiring a Romanian visa will have to attach to their application form a valid travel document, acknowledged by the state of Romania, as well as all the documents required under the law, in order to confirm the stated purpose of the trip, the duration of the stay, the fact that they have the financial means to support themselves during the stay, and also to return to their home country or continue the trip to a third state that will grant them entry, upon the end of their stay in Romania. However, depending on the function of the purpose for which the long-stay visa is required, the applicants will have to attach to their application other necessary documents.

After entering Romania on the basis of a long-stay visa, foreigners have to carry out the necessary formalities with the relevant Romanian Immigration Office in view of obtaining a temporary residence permit.

As opposed to short-stay visas, the reasons for which long-stay visas can be issued include continuous activity. For example, a long-stay visa for commercial activities is granted to foreigners who are or will become shareholders or hold administration positions, within Romanian legal entities, but only following the prior approval of the Romanian Centre for the Promotion of Trade and Foreign Investment.

The extension of the right to stay is possible, and in the case of temporary residence permits issued to aliens who have invested a minimum amount of Euro 500,000 or have created over 50 full-time work positions, their initial right of stay of ninety days is extended by three years.

Aliens can obtain permanent residence permits only if they have continuously and legally resided on the Romanian territory in the last five years. The residence is considered as continuous when the period of absence from the Romanian territory is fewer than six consecutive months and it does not exceed a total of ten months.

However, as a special provision, aliens who can prove that they have invested a minimum amount of Euro 1,000,000 or that they have created 100 full-time work positions in Romania, can obtain a permanent residence permit without being required to continuously and legally reside on the Romanian territory for five years.

Under Romanian legislation, holders of permanent residence permits benefit from the same treatment as Romanian citizens regarding (i) access to the Romanian employment market, (ii) access to all forms and levels of education and professional training, including scholarships, (iii) benefits from social security, assistance and social protection, from public heath assistance, tax deductions, (iv) access to public goods and services, including the obtaining of housing, (v) benefits from freedom of association, affiliation and membership in a trade union or professional organization, and (vi) the right to establish and change their domicile on the Romanian territory under the same conditions as Romanian citizens.

The permanent right to stay ends in certain situations, as for example: (i) cancellation or annulment, (ii) obtaining of a permanent residence right on the territory of another state, (iii) in the case of a twelve consecutive months term of absence, excepting the situation in which, during this term, a temporary residence permit for a state member of the European Union was issued, (iv) in the case of a minimum of six consecutive years of absence from the Romanian territory.

Aliens who hold permanent residence permits issued by the relevant Romanian Immigration Office may enter and reside in any of the

member states of the European Union for up to 90 days, within a period of six months, without a visa being required.

Aliens can take up permanent working positions in Romania upon compliance with the following cumulative conditions: (i) the respective vacancies cannot be filled with Romanian, EU, EEA nationals or with permanent residents, (ii) they comply with the special professional training, experience and authorization conditions required by the employer in accordance with the legislation in force and do not have a criminal record incompatible with the activity which is envisaged to be carried out in Romania, (iii) they provide evidence of being medically fit to carry out the respective activity and they have no criminal record that may be incompatible with the activity to be carried out in Romania, and (iv) they conclude a full-time employment agreement.

The above-mentioned conditions do not apply to aliens who exercise the mandate of a director in a company, if there is only one alien appointed to this position.

The above-mentioned are the general rules regarding aliens in Romania. However, restrictions apply in this field temporarily during the pandemic, which may change on a weekly basis.

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ESTABLISHING A BUSINESS ENTITY IN RUSSIA

ILN CORPORATE GROUP

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 at the beginning of 2021 reached 146.2 million people, according to Federal State Statistics Service.

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 (krais), 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. Local consumption was fueled by the introduction of consumer loans and mortgages. The country was exposed to the crisis that started in the final quarter of 2008, as the national Gross Domestic Product decreased to 7.8% for 2009, however by the year 2013 a number of 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 the area of 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 respectively; 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.

The 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 flexible. An LLC may have no more than 50 participants and LLCs with sole participants are not prohibited[62].

The minimum charter capital of an LLC amounts to RUB 10,000 (approx. 140 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 a 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, in order 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 up to RUB 1,000,000 (approx. 13,700 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") ("aktsionernoe 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

[62] 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

to capital markets and securities applies to JSCs. Moreover, corporate legislation applicable to JSCs appears to be more imperative and precise.

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. 1,370 USD), whereas the minimum authorized capital for a NJSC is RUB 10,000 (approx. 140 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, as a general rule, 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 ("tovarishestvo" 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 ("tovarishestvo 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 1st 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 in the course of innovative activities (including venture activities). A business partnership is determined by the law as a commercial organization created by two 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 pre-emptive 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 on, 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 on the basis of 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 of these 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 on 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 simplify further business operations and development.

The next section will disclose 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 the foundation or through the reorganization of a currently existing entity. An LLC is established on the basis of 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 (however, stamp duty is not paid if the documents are filed by electronic means). 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 its business activities on the basis of 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 Russian translation of the apostilled extract from the

Trade register of foreign companies acting as participant(s) in the future legal entity.

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 in the presence of the local Notary, apostilled (legalized), filed by post, then translated into Russian (with the notarial certification of the translator's signature by the Russian notary officer), and then submitted to the Tax authority by the authorized person acting pursuant to Power of Attorney. Though that will significantly increase the duration of the process.

Besides, the applicant can file the documents for state registration to Tax authorities by post, through a multifunctional center, or in electronic form through the applicant's personal account. Note, that as of August 2021, incorporation documents of legal entities can also be sent to the Tax authorities directly by a notary.

Upon the submission of the full set of LLC incorporation documents to the Tax authorities, the consideration of the documents by the Tax authority takes three business days starting from the date following the documents' submission to the Russian Tax Authorities. If a positive decision regarding state registration is passed by the Tax authority, the legal entity's incorporation documents can be collected from the Tax authorities by an authorized person acting pursuant to Power of Attorney[63]. The second step consists of the registration of the newly established legal entity with the Statistics authorities and non-budgetary funds – Russian Tax authorities transfer all required data to non-budgetary funds and Statistics authorities within the mutual interdepartmental procedure. This step usually takes no more than 5-8 business days from incorporation. The third step consists of opening an operating bank account.

Opening the operating account generally takes around 3-5 business 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

[63] However, according to recent changes introduced to the Law on registration, the legal entity's incorporation documents are to be provided in electronic form. Request for the documents to be provided in paper form can be included by the applicant in the registration application.

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 similar to 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)[64].

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 15 days after its accreditation.

Within the period of 12 months since adopting a decision on opening a 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 the enactment of the Federal law dated 5 May

[64] 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.

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 namely, apostilled documents on the head company including an extract from the Trade register of foreign companies, tax registration certificate, incorporation documents; resolution on establishment; Regulations of representative office in Russia; Power of Attorney granted to Head of representative office; stamp duty payment notice), 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 making a decision on accreditation by the FTS is no more than 25 business days (for foreign legal entity that carry out activities in civil aviation this term is no more than 20 business days);
- document on introduction of entry to the Register constitutes a proper confirmation of accreditation;
- FTS may decide to suspend registration actions for accreditation, amend the information contained in the register, or terminate the accreditation of a branch or representative office in case not all required documents have been submitted, or the submitted documents do not correspond to the established forms, formats, or requirements for their design;
- 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 a branch or representative office opening purposes to the legislation, as well as in the case that 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 business days from the day of delivery of proper documents to the FTS.

The management of the RO or branch is carried out on the basis of 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/her 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 a RO or branch.

RO foreign employees 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 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 extraordinary 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 the notary unless the Charter provides for other ways of affirming these facts.

Russian law contains certain provisions for protecting minority shareholders' rights and interests. Shareholders' rights including the right to control, property rights, and the right to information allow 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 corporate body 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 LLC. 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, its formation and powers may be stipulated by the Charter.

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 the 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 can 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, to protect shareholder rights from violation by the management. The CEO and members of collective executive bodies cannot preside and constitute more than one fourth of the 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 capitals. 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

Similar 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 with regard to their types, powers, and functions.

Representative Offices and Branches

The affairs of branches and representative offices are administrated by the head of the subdivision. 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 this is restricted by the head company.

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. The 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(credit bureau; fund, in case its receipt

of property, including monetary means, for the period prior to the auditing period are more than RUB 3,000,000 (approx. 410,000 USD), 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 before the auditing period are more than RUB 800,000,000 (approx. 11,000,000 USD) or the value of company assets is more than RUB 400,000,000 (approx. 5,500,000 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 similar to 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 an NJSC as well as in an LLC, it is not obligatory to establish an 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 workplace. 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, Capitalization, 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. A list of priority investment projects is maintained by the Russian government.

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 are 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 includes: 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 RUB 20,000 (approx. USD 270) 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 associated 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 2018 this rate is calculated considering the provisions of clause 1.2 art. 269 of the Tax Code of the Russian Federation, where amounts of applicable interest rates are established depending on the specific currency. For instance, the rates shall meet the following criteria:

1) For loan agreements in RUB: the rate shall be 75-125% from the Bank of Russia key rate (6.5% as of this Review).
2) For loan agreements in USD: the rate shall be from LIBOR rate multiplied by 4 percentage points till LIBOR rate multiplied by 7 percentage points.

Therefore, in order 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 certain percentages as stipulated by clause 1.2 art. 269 of the Tax Code of the Russian Federation (as it was mentioned earlier), 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 (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 (the "HQS"). The hiring procedure and timeframes depend on the status of the foreign citizens involved.

Please note that it is also a decisive point whether or not the company would like to employ the CEO and members of staff as HQS under Russian law. An HQS is an employee with an annual salary amounting to RUB 167,000 (approx. 2,300 USD) per one calendar month. An 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 a 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 Labor and Social Protection 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 RUB 167,000 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 taken by the company in order 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 permission 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 in order 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 in order 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 9 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;
- visa to enter the Russian Federation in order to obtain a temporary residence permit in the Russian Federation.

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.

However, that in order to protect the population and prevent the spread of COVID-19 infection, from March 2020, the entry to the Russian Federation of foreign citizens has been temporarily restricted. The crossing of the state border of the Russian Federation through road, rail, pedestrian, river, and mixed checkpoints was limited. As of September 2021, a list of foreign states is approved, whose citizens can enter the Russian Federation from these states through air checkpoints across the state border of the Russian Federation.

Procedure and terms of obtaining a business visa

To obtain a business 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 in general:

- a valid identity document, accepted as such by the Russian Federation;
- a completed visa application form;
- one photograph;
- 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;
- certificate of consular fee payment.

Ordinary business visas are issued on the basis of 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 on the basis of 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 with 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 RUB 3,000,000 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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LML Alliance is an alliance of two leading Russian law firms, Maxima Legal and Lidings, who advise Russian and international companies in a variety of sectors on all legislative aspects of doing business in Russia and the CIS. Among our clients are market leaders, international investors, representatives of medium and large global businesses interested in entering the Russian and CIS markets and pursuing projects in the region.

Over the years, both firms have assembled teams of dedicated and experienced professionals and have earned a reputation as reliable legal partners both in the domestic and international markets. The firms' cooperation has allowed us to operate fully in the markets of Moscow and St Petersburg simultaneously and to deepen our level of legal expertise; complementing our strengths and areas of practice, as well as significantly strengthening the teams of lawyers who are ready to support larger and more diverse assignments and projects.

Through ongoing cooperation with leading national legal advisors and government authorities in all regions of Russia and the CIS, we have access to experts in any region of the country and are able to solve clients' legal issues effectively regardless of project complexity and scope.

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ESTABLISHING A BUSINESS ENTITY IN SINGAPORE

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN SINGAPORE

This guide offers an overview of various business entities in Singapore. It is meant as a brief introduction only and is certainly not comprehensive. Other requirements, considerations and restrictions may apply. Further specific advice should hence be sought from legal advisors, tax consultants and where applicable, industry specialists before establishing a business entity in Singapore which best suits one's business needs and goals.

The contents below reflect the law in Singapore as of 14 October 2021.

Registration of Business Entities

Unless exempted, business entities must be registered with the Accounting and Corporate Regulatory Authority (**ACRA**) via their business filing portal: BizFile+. A foreigner residing overseas would need to engage the services of a registered filing agent (for example, a law firm, accounting firm or corporate secretarial firm) to submit the online application on his behalf. Goodwins Law Corporation is a registered filing agent.

Upon successful registration, the business entity will be issued with a system-generated Unique Entity Number (**UEN**). The UEN is an identification number that all business entities need to use when transacting with government agencies.

Types of Business Entities

The types of entities available in Singapore through which businesses are conducted include the following:-

1. Company
2. Branch of a Foreign Company
3. Partnership
4. Limited Partnership (**LP**)
5. Limited Liability Partnership (**LLP**)
6. Sole proprietorship
7. Business Trust
8. Variable Capital Company (**VCC**) (special vehicle for collective investment schemes)

(1) Company

Companies must comply with the provisions of the Companies Act (Cap 50) and other regulations and requirements of ACRA unless otherwise exempted.

The governance of a company and the relationships between the company, its shareholders and directors are covered in the company's constitution (formerly known as the memorandum and articles of association) and the Companies Act.

Shareholders of a private company may also enter into shareholder agreements amongst themselves on their agreement in relation to specific rights and obligations as well as the management of the company.

Public companies that are listed on a stock exchange must also comply with the Listing Manual and other rules and regulations of the stock exchange.

Types of Companies

There are several types of companies which one may choose from:-

Private Companies		Public Companies	
Exempt Private Company (EPC)	**Private Company Limited by Shares**	**Company Limited by Shares**	**Company Limited by Guarantee (CLG)**
Maximum of 20 individual shareholders. (The shareholders cannot be a corporation)	Maximum of 50 shareholders. (A shareholder may be a corporation)	No limit on the number of shareholders	No shareholders. Have members instead
		May raise capital by offering shares or debentures to the public	The member must agree to pay a fixed sum in the event the company is wound up
			Such structure is usually adopted for non-profit driven organisations such as charities and performing arts groups

Separate Legal Entity

A company is a separate legal entity from its shareholders/members and directors. The company may own property and may sue or be sued in its own name. Shareholders'/members' liability is limited, and they are not personally liable for debts and losses of the company.

Share capital

A company can be registered with a minimum paid up capital of SGD 1 (or its equivalent in any currency). The capitalisation may be increased by the issuance and allotment of further shares.

Shareholding

There is no requirement for local shareholding. Subject to its constitution, a company may have a minimum of one shareholder.

As Singapore allows 100% foreign ownership of locally incorporated companies, no control is lost in setting up a subsidiary company in Singapore and a foreign parent-company can enjoy the numerous tax benefits applicable to local resident companies. Hence, incorporating a subsidiary company is often the preferred option for small to mid-sized foreign companies.

Under the single-tier corporate tax system, profits are taxed at the company level. Dividends received by shareholders are not taxable.

Minority shareholders' rights and protection

Minority shareholders may rely on Section 216 of the Companies Act to apply to the Singapore Courts for remedies in cases of oppression, injustice in the conduct of the company's affairs or where shareholder's interests have been disregarded.

The Court may make orders to undo the unfairness. This includes imposing injunctions to direct or prohibit an act, varying the terms of the transaction(s) or resolutions in question, giving directions on how future affairs are to be conducted or ordering the company to be wound up (especially in a deadlock situation).

The Court may even modify the constitution of the company if it is deemed necessary to avoid similar unfair outcomes or mandate the purchase of the minority shareholders' shares in the company and/or order damages in favour of the minority shareholder.

Directors

There must be at least one local director who is ordinarily resident in Singapore.

A director is a person in charge of managing the affairs of the company. He must make decisions objectively and in the best interests of the company.

The director must also meet the following basic requirements:-

(1) At least 18 years of age and of full legal capacity;

(2) A Singapore Citizen, Singapore Permanent Resident or foreigner who is an EntrePass holder or Employment Pass (EP) holder with a letter of consent issued by the Ministry of Manpower;

(3) Is not disqualified from acting as a director of a company (for example, is not an undischarged bankrupt or has not been convicted of offences involving fraud or dishonesty punishable with imprisonment for 3 months or more).

Unless the constitution provides otherwise, a company may appoint a director by ordinary resolution.

Company secretary

A company must appoint a secretary within 6 months from its incorporation date. The company secretary must be:

(1) A natural person; and

(2) Locally resident in Singapore.

The position of company secretary must not be left vacant for more than 6 months.

A director may also be a company secretary unless he is the sole director of the company.

Goodwins Law Corporation offers company secretarial services to many of its clients.

Auditor

Every company must appoint an auditor approved by ACRA within 3 months of incorporation unless it is exempted from audit requirements under relevant sections of the Companies Act.

Exempt private companies

Small companies are exempt from audit requirements. Small companies which are either holding companies or subsidiaries will, however, only qualify for such an exemption if the corporate group to which they belong is regarded as a "small group".

A small company is defined according to its financial year:-

(1) it is a private company throughout the financial year; and

(2) it satisfies any two of the following criteria for each of the two financial years immediately preceding the financial year:

(a) the revenue of the company for each financial year does not exceed SGD 10 million;

(b) the total assets of the company at the end of each financial year does not exceed SGD 10 million; and/or

(c) it does not have more than 50 employees at the end of each financial year.

In lieu of annual returns, exempt private companies must submit a declaration signed by the directors and company secretary to confirm the solvency of the company.

Financial statements should still be prepared and made available for ACRA's inspection even though these need not be audited.

Statutory requirements

It is mandatory to hold an annual general meeting (**AGM**) (attended by the shareholders) every calendar year. The company's financial statements and appointment of auditors are tabled at the AGM for the shareholders' approval.

Unless exempted, a company must also file annual returns (**AR**) on Bizfile+ along with the approved financial statements.

The AR contains details of the company such as the name of the directors, secretary, its shareholders, share capitalisation and any changes and updates to these particulars. The purpose is to provide information to stakeholders to make informed decisions.

Subsidiaries of a Foreign Company

The incorporation of a subsidiary is a way for foreign businesses to establish a presence in Singapore.

The subsidiary is a separate legal entity from its parent with the parent company holding more than 50% of the total shareholding.

For consistency and easier accounting group-wise, the subsidiary can opt to have a paid-up capital in the same currency as the parent/holding company and a financial year end that matches with the parent.

The subsidiary is taxed as a Singapore company and can benefit from the many local grants and tax incentives.

Earnings from the subsidiary may be repatriated out of Singapore.

(2) Branch of a Foreign Company

Apart from incorporating a company as a subsidiary of its parent/holding company overseas, a foreign company may also enter the Singapore market by setting up a branch office in Singapore.

As a branch office is considered an extension of the head office of the foreign company, it may not benefit from all grants and tax incentives extended to local entities. The parent remains fully liable for the acts, debts, and losses of the branch office. The branch is required to submit its own audited accounts as well as that of the head office.

It must bear the same name of the parent company which must be approved by ACRA.

The branch must have at least one authorised representative who is ordinarily resident in Singapore.

(3) Partnership

A partnership is a business owned by two to twenty partners. The limit in the number of partners does not apply to partnerships formed solely or mainly for the purpose of carrying on any profession that is regulated by other legislation (for example, law firms, accounting firms and medical practices).

The partnership needs to be registered with ACRA under the Business Names Registration Act 2014. The registration needs to be renewed every one or three years.

The rights and obligations of partners amongst themselves may be governed by a partnership agreement. Where there is no partnership agreement or where the agreement is not comprehensive, the relationship between partners is governed by the relevant provisions of the Partnership Act (Cap 391).

Unlimited Liability

The partnership is not a separate legal entity from the partners. The partners collectively own the assets of the partnership, and each partner is liable jointly and severally with all his other partners for the full debts and liabilities of the partnership, subject to any restrictions or limitations agreed in the partnership

agreement. It should, however, be noted that such a restriction and limitation is between the partners only and will not affect outsiders dealing with the partner unless the restriction/limitation is known by that outsider. Retired partners remain liable for obligations incurred during their partnership.

Partners are taxed individually on their share of the partnership's profits.

Partners

A partner must be:-

(1) at least 18 years old and of full legal capacity;

(2) a Singapore Citizen, Singapore Permanent Resident, or a foreigner holding an EntrePass.

Partners are agents of each other and of the partnership firm. A partner's acts in relation to the business operations of the firm will be treated as being the actions of the firm and all its partners. The firm and all its partners may be sued for any wrongful act committed by any partner in the course of the business of the firm or with the authority of his co-partners.

Authorised Representative

At least one locally-resident authorised representative must be appointed if all the partners are foreigners residing overseas.

A partnership may be converted into a limited partnership.

(4) Limited Partnership (LP)

The structure and basic requirements under a partnership generally apply to an LP save that an LP is a partnership of a minimum of two partners with at least one "general partner" and one "limited partner" pursuant to an LP agreement. Partners can be individuals or corporations. The existence of limited partner(s) and the need for registration pursuant to the Limited Partnership Act distinguishes an LP from a partnership.

Partners

The general partner has the same role as a partner in a partnership. A general partner is responsible for the actions of the LP and is liable for all debts and obligations of the LP.

On the other hand, a limited partner is not liable for debts and obligations of the LP beyond his contribution agreed in the LP agreement, provided he does not take part in the management of the LP.

The limited partner is not entitled to dissolve the LP and the LP is not dissolved by the death, dissolution, bankruptcy, or liquidation of the limited partner.

Manager

Appointing a local manager is not mandatory unless all the general partners are residing outside Singapore.

The local manager is personally responsible for discharging all obligations of the LP. He is subject to the same responsibilities, liabilities, and penalties as a general partner of the LP if the general partner defaults in respect of such obligation.

The manager of an LP must not be an undischarged bankrupt (unless he has obtained permission from the High Court or of the Official Assignee).

(5) Limited Liability Partnership (LLP)

An LLP is a mix between a company and a partnership. It gives owners the flexibility of operating as a partnership while having a separate legal identity like a private limited company.

The partners' relationship is governed by the LLP agreement entered into between the

partners and the Limited Liability Partnership Act.

This structure is generally used for professional practices such as doctors, lawyers, architects and engineers etc.

Separate Legal Entity

Like a company, the LLP is a separate legal entity from the partners. This means that any change in the partners of an LLP will not affect its existence, rights, or liabilities.

Although the partners of the LLP will not be held personally liable for any business debts incurred by the LLP, a partner may, however, be held personally liable for claims from losses resulting from his own wrongful act or omission. A partner will not be held personally liable for wrongful acts or omissions of any other partner of the LLP.

Partners

The LLP must have at least two partners. The partner can be an individual (at least 18 years old of full legal capacity), a local company, a foreign company, or another LLP. Partners are considered agents of the LLP.

Manager

There must be at least one manager to oversee or take part in the management of the LLP.

The manager is responsible to ensure that the LLP complies with the requirements of the Limited Liability Partnership Act.

The manager must be an individual ordinarily resident in Singapore. He/she may be a partner of the LLP. The manager cannot be an undischarged bankrupt unless with leave of the High Court or written permission of the Official Assignee.

Statutory requirements

An LLP is required to keep accounting records, profit and loss accounts and balance sheets that will sufficiently explain the transactions and financial position of the LLP.

The LLP must submit an annual declaration of solvency or insolvency which will be made available to the public.

(5) Sole Proprietorship

A sole proprietorship is a business that can be owned and controlled by a sole individual, a company, or an LLP.

Unlimited liability

The sole proprietorship is not a separately legal entity from the business owner (sole proprietor). The sole proprietor has unlimited liability and will be personally liable for all debts and losses of the sole-proprietorship. The sole proprietor will have to sue and be sued in his own name.

Sole proprietor

A sole proprietor must be:-

(1) at least 18 years old and of full legal capacity;

(2) a Singapore Citizen, Singapore Permanent Resident, or a foreigner holding an EntrePass.

Authorised representative

Sole proprietors who are foreigners residing overseas must appoint at least one locally-resident authorised representative.

(7) Business Trusts

A Business Trust is a trust created under a trust deed to operate and run a business enterprise.

Business trusts which meet certain criteria stipulated in the Business Trusts Act (Cap. 31A) will have to be registered under the Act.

Business trusts that are not registered under the Business Trusts Act are governed by the general law of trusts and by the provisions in the Trustees Act (Cap 337).

The business trust is a not a separate legal entity and the trustees are the legal owners of the assets in the trusts.

Trustee-manager

Business trusts registered under the Business Trust Act must have a trustee-manager.

The trustee-manager must be a non-exempt company incorporated in Singapore with the sole business of managing and operating the trust.

The trustee-manager has legal ownership of trust assets and holds them on behalf of the business trust and manages the trust assets for the benefit of the beneficiaries (called "unitholders").

(8) Variable Capital Company (VCC)

Introduced in January 2020, the VCC is the newest legal vehicle to be introduced in Singapore through the Variable Capital Companies Act.

It is tailor-made for collective investment schemes (CIS). The take-up rate for VCCs has been very encouraging since its launch.

A VCC:

(1) has a variable capital structure that provides flexibility in the issuance and redemption of its shares. It can also pay dividends out of capital, which gives fund managers flexibility to meet dividend payment obligations;

(2) can be set up as a single standalone fund or an umbrella fund with two or more sub-funds, each holding a portfolio of segregated assets and liabilities. For fund managers that structure their funds as umbrella VCCs, there may be cost efficiencies from using common service providers across the umbrella and its sub-funds;

(3) can be used for both open-ended and closed-end fund strategies;

(4) Fund managers may incorporate new VCCs or re-domicile their existing overseas investment funds with comparable structures by transferring their registration to Singapore as VCCs and

(5) must maintain a register of shareholders, which need not be made public. However, this register must be disclosed to public authorities upon request for regulatory, supervisory and law enforcement purposes.

Permissible Fund Manager

All VCCs must be managed by a Permissible Fund Manager.

A Permissible Fund Manager refers to:

(1) a licensed fund management company which holds a capital markets services licence for fund management; or

(2) a registered fund management company; or

(3) a financial institution exempted from holding a capital markets services licence to carry on fund management, for example, a bank, finance company or insurance company.

The Permissible Fund Manager will have to provide a declaration that fulfils one of the above criteria and consents to act as the fund manager of the VCC.

Director

The VCC must have at least one director who meets the following requirements:-

(1) at least 18 years old and of full legal capacity;

(2) a Singapore citizen, permanent resident or foreigner who is a holder of EntrePass or Employment Pass with the appropriate letter of consent from the Ministry of Manpower;

(3) is ordinarily resident in Singapore; and

(4) is not disqualified from acting as a director of the VCC (for example, is not an undischarged bankrupt).

In addition, at least one director must be either a qualified representative (as defined under the Variable Capital Companies Act 2018) or a director of its fund manager.

Company secretary and auditor

Requirements applicable to a company similarly apply to the VCC.

Anti-Money Laundering and Countering the Financing of Terrorism

The anti-money laundering and countering the financing of terrorism obligations of VCCs come under the purview of the Monetary Authority of Singapore (MAS).

Inward Re-domiciliation of Foreign Corporate Entities

Apart from applying to register a new business entity in Singapore, whether as a subsidiary or branch or otherwise, foreign corporate entities have the additional option of applying to transfer their registration to Singapore (inward re-domiciliation). A foreign corporate entity which re-domiciles to Singapore will become a Singapore company and will be required to comply with the Companies Act.

Re-domiciliation will not affect the obligations, liabilities, properties, or rights of the foreign corporate entity.

Post-registration requirements

Upon approval of the application, the entity will be registered as a company limited by shares in Singapore.

Once the foreign corporate entity is registered as a company in Singapore, a document evidencing deregistration of the foreign corporate entity in its place of incorporation must be submitted within 60 days after the date of registration. If the company requires more time to provide the document, the company may apply for an extension of time, for a fee and subject to ACRA's approval. The Registrar may revoke the registration of the company if the document is not submitted within 60 days after the date of registration, or within such longer period as the Registrar has approved.

Companies should deliver new share/debenture certificates to their holders within 60 days after the date of registration. Companies should also register their pre-existing charges with ACRA within 30 days after the date of registration. Share warrants issued before the date of registration are void.

If the foreign corporate entity was registered as a foreign company under the Companies Act before re-domiciliation, the foreign company registration will cease.

Licences and Approvals

Certain business activities may be regulated or require licences or approvals from other government agencies. A business entity which deals in such business activities may not commence business operations even after it is registered with ACRA, unless and until it has met with all other requirements and has

obtained the necessary licences and approvals from the relevant authorities.

For example, for fund management activities, there will be other requirements and restrictions imposed by MAS including the need for a licensed fund manager, charities would have to be registered with the Commissioner for Charities and approval from the Ministry of Education would have to be sought before a business entity can operate a private school.

Factors affecting the choice of a business entity type

The suitable type of business entity depends on your business needs and goals.

The following are some of the factors to be considered in determining the best structure:

(1) What is the nature of the business?

(2) How much capital are you prepared to invest?

(3) How many owners will there be?

(4) What liabilities and responsibilities are you prepared to assume?

(5) What risks are you prepared to take?

(6) What are the advantages and disadvantages of the different business entities?

(7) What are the tax implications?

(8) The cost, formalities, and requirements to maintain the business entity.

Below is a table on the comparison in relation to the main business structures:-

	Sole Proprietorship	**Partnership**	**Limited Partnership (LP)**	**Limited Liability Partnership (LLP)**	**Company limited by shares**
Generally suitable where:	An individual prefers to run the business on his own	Two to twenty persons come together to carry on business with a view to making profit	At least one partner is not interested in managing the business and is not ready to bear unlimited risk.	Partners are professionals such as lawyers, accountants, doctors, engineers, and architects who are prepared to be taxed at the individual personal tax rate.	Business is managed by a board of directors but owned by shareholders. A director may not necessarily be a shareholder. Possibility of raising further capital through the issuance and allotment of shares to investors
Legal Status	Not a separate legal entity	Not a separate legal entity	Not a separate legal entity	Separate Legal Entity	Separate Legal Entity
Liability	Unlimited liability	Unlimited liability	(1) General partner has unlimited liability (2) Limited partners have limited liability	(1) Partners are personally liable for debts and losses resulting from own actions (2) Partners are not personally liable for debts	Shareholders enjoy limited liability

				and losses of LLP incurred by other partners	
Property Ownership	In owner's name	Cannot own property in firm's name	Cannot own property in firm's name	Can own property in LLP's name	Can own property in company's name
Tax Rate **(1) Personal tax rate: 0% to 22%** **(2) Corporate tax rate: Flat 17%** **(Tax exemptions may be available where applicable)**	Personal income tax rate	Personal income tax rate	(1) Individual partners - personal income tax rate (2) Corporate partners - corporate tax rate	(1) Individual partners - personal income tax rate (2) Corporate partners - corporate tax rate	corporate tax rate
Requirements	Registration needs to be renewed	Registration needs to be renewed	Registration needs to be renewed	One-time registration Annual declaration of solvency must be lodged by one of the managers	One-time registration Must appoint company secretary and auditor (unless exempted) Financial statements to be audited (unless exempted) Annual Returns and financial statements to be filed etc. Company statutory registers and records must be maintained
Continuity	As long as registration is valid until owner's death, bankruptcy or loss of legal capacity or the owner chooses to cease business	As long as registration is valid subject to partnership agreement and Partnership Act	As long as registration is valid subject to cessation by a general partner according to the LP agreement and Limited Partnership Act	Until wound up or struck off	Until wound up or struck off

Tax Considerations

All businesses are subject to tax on all profits that arise in or are derived from Singapore.

Income tax is imposed on sole proprietors and individual partners whilst companies are liable for corporate tax. Goods and services tax (GST) will apply to businesses with revenue exceeding SGD 1 million over a 12-month period.

While the foreign-sourced income of an individual is generally not taxable, foreign income of a company that is derived from outside Singapore but remitted to and received in Singapore is taxable.

Income Tax

Singapore adopts a progressive personal income tax rate scheme currently capped at 22% in respect of chargeable income in the year of assessment exceeding SGD 320,000.

Corporate Tax

The current corporate tax is a flat rate of 17% on chargeable income.

Goods and Services Tax (GST)

Businesses with an annual turnover, or expected to have a turnover, exceeding SGD 1 million over a period of 12 months must register with the Inland Revenue Authority of Singapore (IRAS) and charge and collect GST on their supplies which must be paid to IRAS.

GST is a consumption tax levied on the import of goods and almost all supplies of goods and services in Singapore. Supplies that are exempt from GST include:-

(1) provision of certain financial services;

(2) sale and lease of residential properties;

(3) importation and local supply of investment precious metals (IPM); and

(4) the supply of digital payment tokens (with effect from 1 January 2020).

The prevailing GST rate is 7%.

GST that is incurred when purchasing from GST-registered suppliers or importing goods into Singapore (input tax) can be claimed during the accounting period that matches the date shown in the tax invoice or import permit.

Some of the conditions which must be satisfied to claim input tax include:

(1) the goods or services must have been or will be used for the purpose of the business;

(2) local purchases must be supported by valid tax invoices addressed to the business, or simplified tax invoices at the time of claiming the input tax;

(3) imports must be supported by import permits that show the business as the importer of the goods;

(4) the input tax must be directly attributable to taxable supplies; and

(5) the input tax claim is not disallowed under any relevant regulations.

Tax residency

Companies are generally taxed in the same manner regardless of whether they are tax resident. However, non-resident companies are not able to enjoy certain benefits available to resident companies. Some of these benefits include:

(1) Tax exemptions for start-up companies.

(2) Tax benefits under double taxation agreements (DTAs).

(3) Tax exemptions on foreign-sourced dividends, foreign branch profits, and foreign-sourced service income.

A company is regarded as a tax resident if the control and management of the company is

exercised in Singapore. One of the key factors in determining where such control and management is exercised is the location of the company's board of directors' meetings where strategic decisions such as those on company policy and strategy are made.

Double Taxation Agreements (DTAs)

Singapore has entered into DTAs with 89 tax jurisdictions, including Australia, China, Japan, the United Arab Emirates and the United Kingdom.

A DTA is an agreement concluded between Singapore and another jurisdiction (a treaty partner) which serves to relieve double taxation of income that is earned in one jurisdiction by a resident of the other jurisdiction. It spells out the taxing rights between Singapore and the treaty partner on the different types of income arising from cross-border economic activities between the two jurisdictions.

The DTA also provides for reduction or exemption of tax on certain types of income.

When a Singapore tax resident earns foreign income from a treaty partner, the Singapore tax resident may claim benefits under the DTA that entitles the tax resident not to pay tax or to pay tax at a reduced rate in the foreign jurisdiction.

When a Singapore tax resident receives foreign income, it may suffer tax in both Singapore and the foreign jurisdiction. The DTA provides relief against this double taxation by allowing the Singapore tax resident to claim a credit of the foreign tax suffered against its Singapore tax payable on the same income.

Grants for Foreign Companies/Start-Ups

To develop a vibrant ecosystem for businesses in Singapore, the Singapore government is on a constant look-out to lower barriers to entry and exit for businesses as well as to enable local businesses to seize new opportunities locally and overseas.

In a bid to encourage businesses to establish a strategic base in the city-state and manage their growth strategies and international operations from here, the government provides a range of incentives to a broad spectrum of industries. These include tax holidays and concessions, accelerated depreciation schemes, grants and favourable loan conditions.

Depending on the incentive or business grants in Singapore being sought, the approving government authority may be the Singapore Economic Development Board (EDB), International Enterprise Singapore (IE Singapore), Monetary Authority of Singapore (MAS) or Maritime and Port Authority of Singapore (MPA) etc.

Some of these incentives and grants available are negotiated and agreed on a case-by-case basis, and the award period typically ranges from three to up to ten years.

Responses to Covid-19

In light of the negative impact of the COVID-19 outbreak on the economy (locally and worldwide), the Singapore government has since 2020, announced several packages and measures to support enterprises with cash flow relief starting with the Stabilisation and Support Package amounting to a total of SGD 4 billion and most recently, the Stabilisation Phase Support Measures.

Reliefs under the Stabilisation and Support Package included: -

(1) corporate Income Tax Rebate for YA 2020, at a rate of 25% of tax payable, capped at SGD 15,000 per company;

(2) enhancements to several tax treatments under the corporate tax system for one year, for example, faster write-down of

investments in plant and machinery, and renovation and refurbishment, incurred for YA 2021, for enterprises; and

(3) enhancement of the Enterprise Financing Scheme by raising the maximum loan quantum and increasing the government's risk-share on the loans.

Under the Stabilisation Phrase Support Measures for which SGD 650 million is set aside, the reliefs include: -

(1) enhancement of the Jobs Support Scheme (JSS) for the period of 27 September through 24 October 2021 for sectors significantly affected by the tightened measures. These include F&B, retail, cinemas, museums, art galleries, historical sites, family entertainment, tourism, gyms and fitness studios, and performing arts and arts education; and

(2) a 2-week rental waiver for qualifying tenants on Government-owned commercial properties.

Qualifying tenant-occupiers and owner-occupiers of privately-owned commercial properties will also be given a 2-week rental relief cash pay-out under a Rental Support Scheme.

Goodwins Law Corporation shall be glad to assist anyone keen to explore business opportunities in Singapore and assist in the incorporation or registration of the type of business entity that would best suit needs and goals of the business.

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INTERNATIONAL LAWYERS NETWORK

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ESTABLISHING A BUSINESS ENTITY IN SLOVAKIA

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN SLOVAKIA

1. Types of Business Entities

The currently available local corporate structures for conducting business are:

- General partnership
- Limited partnership
- Limited liability company
- Joint-stock company
- Simple joint-stock company
- Branch office
- A Cooperative

1.1 Description of the types of entities available in each jurisdiction through which to conduct business

While the liability of the members of partnerships for the debts of the company is, in general, unlimited, the other corporate structures offer limited liability for the shareholders. For this reason, the most frequent company types are the Limited liability company ("LLC") and the Joint-stock company ("JSC"). Simple joint-stock company is becoming increasingly popular "start-up" company structure.

1.1.1. Limited liability company

A Limited liability company (Sk. "*spoločnosť s ručením obmedzeným*") is the most common form of commercial company in Slovakia.

A limited liability company may be founded by one or more (up to 50) individuals or companies irrespective of their nationality. A company with a sole member cannot be the sole member of another company (chaining ban). An individual may be the sole member of up to three companies. This rule also applies to foreign LLCs or individuals. The company cannot be established by a founder with tax, customs duty, or social insurance arrears, unless a consent of the respective authority is issued. Moreover, LLC also cannot be established by a person recorded as a debtor in the Register of issued authorizations to perform issued enforcement authorisation. This does not apply to foreign companies or individuals.

The minimum capital requirement for an LLC is EUR 5,000 and the minimum contribution of each shareholder is EUR 750. If the company has a sole founder, the registered capital must be paid up in full before it is registered in the Commercial Register. If there is more than one founder, at least 30 per cent of each member's contribution to the registered capital, and overall, at least 50 per cent of the minimum registered capital must be paid up before registration in the Commercial Register.

Monetary or non-monetary (in-kind) contributions are allowed, namely real or movable property, certain intangible assets, and existing and documented due debts. The value of in-kind contributions is subject to an official valuation and these contributions must be fully paid up before the registration of the LLC in the Commercial Register.

However, it is advisable to count on a reasonable starting amount for the registered capital for financing the launch of the business and thus avoiding the application of the insolvency or statutory economic crisis test from the very beginning.

1.1.2. Joint-stock company

A Slovak joint stock company (Sk. "*akciová spoločnosť*") is similar to other European joint-stock companies.

Joint stock companies may be established by one or more legal entities or by two or more individuals (resident or non-resident) and may have a public or private form. A JSC whose shares (or some of them) have been listed on

the stock exchange in any EEA member state is considered a public joint stock company.

The minimum registered capital for a JSC, regardless of the method of establishment, is EUR 25,000 (special, significantly higher, registered capital requirements apply JSCs intended to operate e.g., as banks, investment companies, securities dealers, and management companies).

Shares are securities entitling the shareholders to participate in the company's management, and to share in the profit and liquidation balance. Shares are issued as either registered (Sk. "*akcie na meno*") or bearer (Sk. "*akcie na doručiteľa*") shares.

Registered shares may be issued as certified/paper form (Sk. "*listinné*") or book-entry (Sk. "*zaknihované*") securities, whilst bearer shares are issued in book-entry form only.

Generally, shares are freely transferable. However, the articles of association may restrict (but not prohibit completely) the transferability of registered shares (not bearer shares) to specific cases.

2. Steps and Timing to Establish

The aim of this section is to give a brief general overview of the necessary steps for the incorporation of a capital company (e.g., LLC or JSC) in Slovakia.

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

After executing the foundation document (i.e., in the period between its foundation and registration) the company does not yet legally exist; in other words, it does not have legal personality and it cannot acquire rights or obligations except for some specific circumstances.

The company's founders must authorize a person to administer the paid-up capital before registering 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.

To carry out business activity, the company must obtain the corresponding business licence, namely a trade licence or other licence under special regulation. A trade licence, being the most common business licence, is certified by an extract from the Trade Register held by the Trade Licensing Office. The company acquires the trade licence, in the extent of the registered scope of business, upon incorporation.

Each newly founded company acquires a legal capacity of their own upon incorporation, i.e., registration with the Commercial Register. An application for registration in the Commercial Register must be filed within 90 days of the company's foundation, or from the date of delivery of a document establishing a trade licence or other business licence. In the Slovak Republic, the Commercial Register is administered by eight appointed District Courts. Corporate information on the companies registered in the Commercial Register such as business name, address, authorized representatives, registered capital, and certain others can be found online at the website www.orsr.sk (the online data is not sufficient for legal purposes). In general, if an application to register a company in the Commercial

Register fulfils all of the requirements, and all of the necessary documents are supplied, then the company is registered within two working days of the application being filed.

3. Governance, Regulation and Ongoing Maintenance

Brief summary of regulation of each type and ongoing maintenance; reporting requirements

Corporate governance is vested in the company's bodies and varies by the type and size of the company. For the capital companies, the supreme body is always the general meeting of its shareholders.

The supreme body of a Slovak **LLC** is its general meeting, which decides on the most important company matters.

The company's day-to-day business and representation is ensured by a statutory body consisting of one or more executive directors. The executive directors are entitled to act to the full extent on behalf of the company. If more executive directors are appointed, they may act individually or jointly (they do not formally constitute a board (there is no board of directors in an LLC), but each of them is the statutory body). The executive director of a company may only be a natural person who is not registered as an obliged party in the Register of issued authorizations to perform execution at the time of registration to the Commercial register. The executive director's right to act on behalf of the company may be limited in the founding document, but in principle any limitations are ineffective vis-à-vis third parties. The limitation of the statutory body shall not be more registered in the Commercial register of the company.

Generally, if the executive directors breach their duties they are jointly and severally liable to the company, unless they prove that they acted in good faith, with professional care and in the company's interests.

A supervisory board (consisting of at least three members) may be established voluntarily.

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 the law and the founding documents. 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 Commercial Code, which may be extended by the founding documents.

The bodies of a **JSC** are similar to other European joint stock companies, with a general meeting as the supreme body, board of directors as the executive body, and an overseeing supervisory board.

Major corporate matters can only be decided by the general meeting. The powers of the board of directors, as a company's statutory body, are laid down in the articles of association. The shareholders exercise control over the members of the board of directors through the general meeting and indirectly through a supervisory board elected by and reporting to the general meeting. The board of directors has the power to decide all matters which are not specifically by law reserved for the general meeting, to care for the day-to-day business and to represent the company towards third parties.

The number of directors must be specified in the articles of association. Unless otherwise provided in the articles of association, each director is authorized to act and sign on behalf of the company.

Generally, directors are jointly and severally liable to the company if they breach their obligations, unless they prove that their actions were in good faith, taken with professional care and in the company's interests.

Unlike in an LLC, the supervisory board is an obligatory body of a Slovak JSC. It must have at least three members and it supervises the activities of the board of directors and monitors the company's financial records. If the JSC has more than 50 employees (regular not temporary personnel) two thirds of the members of the Supervisory Board are elected and removed by the General Meeting and one third by the company's employees.

As regards reporting requirements, the most common obligation is related to financial statements. The companies are obliged to deposit their financial statements in the central Register of Financial Statements in an electronic form. A company is obliged to deposit its financial statements by the deadline for submission of Corporate Income Tax Returns (31 March, or if the deadline is extended, not later than 30 June or 30 September). If the company fails to submit the financial statements in due time (no later than 9 months from the preparation of the financial statements) and is in delay with fulfilment of this obligation by more than 6 months, the court will, upon lapse in vain of a remedy period granted by the court, decide to cancel the company even without a proposal.

If a company meets the criteria for obligatory audit[65] of its financial statements, the company is obliged to file its annual report and an auditor's report on verification of the financial statements (including the auditor's report on verification of compliance of the annual report with the financial statements) with the Register of Financial Statements, within one year following the end of the accounting period for which the financial statements were prepared, at the latest.

Requirements applicable to local shareholding/directors

There are no requirements or limitations in respect of nationality of the shareholders – they may be either a Slovak or foreign individual or company.

The board members may be either a Slovak or foreign individual or company (except for members of statutory bodies and supervisory bodies in a joint stock company or a limited liability company). 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.

In respect of non-EU or non-OECD citizens appointed as the statutory bodies of the Slovak companies (executive directors, members of the BoD) a residence permit in Slovakia obtained for business purposes is required. Such requirement does not apply to EU or OECD member states citizens.

[65] The Financial Statements must be approved by an auditor if the company fulfils, in the period for which the Financial Statements are prepared, and in the period preceding the period for which the Financial Statements are prepared, at least two of following conditions for each period:

- the total value of the company's property is more than €2,000,000 (as of 1 January 2022: €4,000,000);
- net turnover is more than €4,000,000 (as of 1 January 2022: €8,000,000);
- the average number of employees is more than 30 (as of 1 January 2022: 50).

Minority shareholders' rights and protection

In general, under the Slovak Commercial Code, the misuse of a shareholders' rights, in particular misuse of a majority or a minority of votes in a company is prohibited.

In the case of an LLC, Slovak law does not specify majority/minority shareholders nor grant efficient protection to minority shareholders. The Slovak Commercial Code grants specific rights to shareholder(s) whose contribution amounts to at least 10% of the registered capital. Such shareholder(s):

i) may request convening of a general meeting (however, other shareholders are not obliged to participate in the general meeting), or

ii) may propose a voting for a specific resolution outside general meeting[66].

Minority shareholders protect their interests also through exercise of general shareholder's rights that the Slovak Commercial Code grants to all shareholders (right to be informed by executive directors, right to demand cancellation of a resolution of a general meeting if statutory or agreed conditions were breached, etc.).

Another form of protection of a minority shareholder is the fact that any change to the founding document that extends the obligations of shareholders or limits or restricts the rights of shareholders must be approved by all shareholders that are affected by such change.

As regards a JSC, the general rule is that no shareholder can exercise its right to the detriment of another shareholder's rights and legitimate interests and that the company must treat every shareholder equally.

Similarly, to an LLC, the Slovak Commercial Code specifies qualified shareholders and grants them specific rights. These qualified shareholders are defined as having at least 5% of the registered capital. Such shareholder(s) are entitled to (e.g.):

i) request the convening of a general meeting (however, other shareholders are not obliged to participate in the general meeting);

ii) request that a specific point be added to the general meeting's agenda;

iii) request the supervisory board to review actions of the board of directors in the designated matters;

iv) request the board of directors to claim the payment of the outstanding part of the issue price from shareholders in default,

v) request the board of directors to claim from shareholders the restitution of performance provided contrary to the law.

In addition, similarly to an LLC, the minority shareholders in a JSC can, however, use for protection general rights that the Slovak Commercial Code grants to all shareholders (right to be informed by executive directors, right to demand cancellation of a resolution of a general meeting if statutory or agreed conditions were breached, etc.).

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

No significant barriers to entry for an offshore party

There are no significant barriers for an offshore party to be a shareholder in the above company types. However, some restrictions may apply to certain types of businesses (e.g., certain regulated activities may be reserved for

[66] The articles of association may extend this right to shareholders with smaller contribution.

Slovak or EU nationals or nationals of a country which has concluded a reciprocal treaty with Slovakia).

Capitalization obligations

The capital requirements for an LLC are set out under Section 1.1.1 of this summary and the capital requirements for a JSC are set out under Section 1.1.2.

Apart from the minimum registered capital, there is another requirement, which is the creation of a reserve fund. A reserve fund is obligatorily created by an LLC and a JSC from profit in the current accounting period, as shown in the approved individual annual financial statements. In the case of an LLC, the company is obliged to create it from net profit reported in the annual financial statements for the first year of the company's profitability, namely in an amount of at least 5% of net profit but no more than 10% of registered capital. In the case of a JSC, the company creates a reserve fund in the amount of at least 10% of the registered capital upon its incorporation. A JSC is obliged to supplement this fund annually by a sum determined in the articles of association, but at least in the amount of 10% of the net profit reported in the annual financial statements, until the reserve fund attains the amount determined in the articles of association, but at least the amount of 20% of registered capital.

The Slovak Commercial Code also defines specific limitations for companies that are considered to be "in crisis". A company is in crisis if it is technically bankrupt or there is a threat of bankruptcy in its respect, or a company during the period between its dissolution and its entry into liquidation. A company is **bankrupt** if it has negative equity or is insolvent and there is a **threat of bankruptcy** if the ratio of its equity and liabilities is less than 8 to 100. The threat of bankruptcy is not directly connected with the immediate threat of insolvency or restructuring proceedings, but it is connected with several consequences. The main consequence or limitation is that all payments received from shareholders, statutory representatives, and related parties, which the company received during its crisis or before the crisis with maturity extended during the crisis, cannot be returned to these parties before it overcomes the crisis. Moreover, even with the potential settlement of liabilities, the company cannot be in crisis again. The payments received during the crisis are considered to be payments replacing the company's own resources.

Special business or investment visa issues

Citizens of the EU/EEA/Switzerland (hereinafter jointly "EU citizen") do not need any special permit to live and work in Slovakia. An EU citizen who is the holder of a valid identity card or travel document is entitled, without any further conditions or formalities, to reside in Slovakia for three months from his/her entry into Slovakia. If the EU citizen resides in Slovakia for more than three months, he/she is obliged to apply for registration of residence in Slovakia. An application for the registration of residence must be filed in an official form in person at a police department within 30 days from the lapse of three months from the entry into Slovakia.

A third country national may apply for one of the following types of residence: i) temporary residence, ii) permanent residence and iii) tolerated residence. Temporary residence can be granted for one of the purposes listed in the Act on Residence of Foreigners (e.g., employment, study, family reunion). A permanent residence permit entails foreign nationals to long-term residence in Slovakia as well as journeys abroad and back. It is a more stable type of residence, which is granted to

foreign nationals for a longer period than temporary residence. Foreign nationals with a permanent residence permit enjoy the same rights and duties as all citizens of Slovakia in most areas of life (e.g., employment, health care, social affairs, and public life on the regional level). Tolerated residence is a special type of residence, which can be granted to a foreign national exceptionally for a short time period in order to overcome a specific situation.

While the employment of an EU citizen in Slovakia is easy and simple, a third country national may be employed in Slovakia only under specific conditions, such as if he/she: i) is an EU Blue Card holder, ii) was granted temporary residence for the purpose of employment on the basis of a confirmation on the possibility to fill in a vacancy – a single permit, iii) was granted a work permit and temporary residence for the purpose of employment, iv) was granted a work permit and temporary residence for the purpose of family reunion within the first 12 months from being granted the residence, v) was granted a work permit and temporary residence of a third country national with acknowledged long-term residence in another EU Member State within the first 12 months from being granted the residence and vi) other.

Restrictions on remitting funds outside of the jurisdictions (withholdings, etc.)

Dividends from profits generated as from 2017 and paid to an entity or an individual resident in a country that has not concluded a tax treaty with Slovakia are subject to a 35% withholding tax. Dividends distributed by a Slovak resident entity (as from 2017 profits) to an entity residing in a country that has concluded a tax treaty with Slovakia is exempt from a withholding tax. Dividends distributed by a Slovak resident entity (from 2017 profits) to individuals residing in Slovakia or a country that has concluded a tax treaty with Slovakia are subject to a 7% withholding tax (the rate may be modified by the tax treaty).

Interest paid to a non-resident entity is subject to a 19% withholding tax (the rate can be reduced by a tax treaty or exempt under EU legislation). A 35% withholding tax applies if the payment is carried out to a resident of a country without a tax treaty. The same applies for royalties.

This memorandum is for information purposes only.

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. Lubomir Lesko (lesko@peterkapartners.sk) or Mr. Jan Makara (makara@peterkapartners.sk).

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INTERNATIONAL LAWYERS NETWORK

BROSA ABOGADOS Y ECONOMISTAS

ESTABLISHING A BUSINESS ENTITY IN SPAIN

ILN CORPORATE GROUP

ESTABLISHING A BUSINESS ENTITY IN SPAIN

1. TYPES OF BUSINES ENTITIES

1.1 Description of the types of entities available in each jurisdiction through which to conduct business

- ***Limited companies: Corporation and Limited Liability Company***

When setting up a business in Spain, either foreign or local investors generally incorporate a company. There are two kind of mercantile companies usually incorporated to operate a business in Spain: (i) Corporations or public limited companies ("Sociedades Anonimas" or "SA") having their capital represented by shares, which are securities; and (ii) Limited Liability Companies or private limited companies ("Sociedades de Responsabilidad Limitada" or "SL") having their capital represented by participation units ("participaciones sociales"), which are not securities (hereinafter referred to both of them as "shares"). In both cases, companies have a legal personality distinct from their partners, which are not liable for the company's debts. Shareholder's liability is limited to their contribution to capital. Only in exceptional cases, based on a fraudulent use of the legal personality, the shareholders shall be liable for the debts or obligations of the company.

- ***Branch***

Branch is a secondary establishment operating as a representative of its parent company, but without being a separate legal entity even though it keeps certain level of autonomy management. So, the parent company is liable for its obligations and debts. Branch develops, totally or partially, the activity of the parent company.

- ***Other options***

  - ***Representative office***

Representative office, as well, is not a separate or distinct legal entity, and its goal is to carry out ancillary, accessory and instrumental activities focused on market prospective, information gathering, scientific research, etc..), but it does not conduct any actual business. The nonresident company is liable for all debts assumed by the representative office.

  - ***Joint Ventures***

Joint Ventures mostly use companies (purchasing or incorporating a corporation or limited liability companies) as vehicle, but it could just be agreed on a contract.

  - ***Acquiring a company***

The quickest way to open a business is to buy a shelf company (an incorporated company that has not been traded yet) instead of incorporating one. It allows to start operating immediately. It is initially faster because the company is already incorporated and registered with the Commercial Registry and already holds a NIF (Tax ID). However, different corporate changes and director's appointment have to be made later on to tailor the company to investors' needs and requirements.

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

Vehicles mostly used to start up a business in Spain are (i) a company (Corporation or Limited Liability Company, basically) or (ii) a branch. So, this guide will focus on such options.

- **Corporation vs Limited Liability Company**

Choosing between Corporation or Limited Liability Company is basically a matter of considering the following points:

- Legal requirements of each type of company. In general terms, the big difference between Corporation and Limited Liability Company is that a Limited Liability Company cannot be listed in the stock market and cannot issue guarantee bonds or other securities that acknowledge or create a debt convertible into units).
- A more flexible regulation of Limited Liability Companies in comparison with Corporations, allowing the by-laws to foresee rules to reinforce the personal nature more than the capital nature of the company. Moreover, being less formal in legal requirements in some respects, the cost of the corporate running is lower. For example, there are fewer legal requirements relating to the publication in official gazettes of by-laws amendments, share capital required is lower, or there is no need of audit report when contributions in kind are made by the members, etc…
- Rules of shares' transfer: restriction on the transfer of shares are stronger in SL than in SA.
- Company's structure and organization: SL regulation is much flexible and leaves to shareholders a greater space to decide on how to organize the company. The mechanisms to protect the capital and the debtors of the company are stronger in SA than in SL where are replaced by partner's or director's liability.

Nowadays, companies incorporated in Spain are basically Limited Liability Companies. Corporations are usually left to large companies, based on the advantage of being easier to invest into shares that can be listed on stock exchanges and are easily transferable.

- **Branch vs Subsidiary**

When considering opening a business in Spain, the decision between establishing a branch and incorporating a company shall be taken considering that:

- To establish a branch is, in principle, simpler since legal formalities are less than to incorporate a company (no need to contribute a capital, no by-laws or articles of association).
- A Branch is not a legal entity; thus, Parent company shall be liable for any liability or debt of the branch.
- Since it is not a legal entity, foreign Parent company shall appoint a resident as representative for tax purposes, who may be jointly and severally liable for tax liabilities of the branch. A branch is considered a permanent establishment under a tax point of view.
- Branches are obliged to file tax returns and financial statements of the parent company shall be submitted to the Commercial Registry.
- Non-residents who operate in Spain through a permanent establishment are generally required to keep accounting records in Spain, in accordance with the rules and procedures established for Spanish companies.

- **Other options: Representative Office**

When considering opening a representative office, it shall be considered that:

- It does not conduct any actual business: the purpose of a representative office is limited to certain complementary activities of the parent company.
- From a tax standpoint, a representative office could be a permanent establishment.

- Due to the lack of specific regulations of a representative office, no commercial requirements shall be met to open it. However, to execute a public deed to open the representative office, to recorder the allocation of founds, the identity of the tax representative and the labor representative (if it is the case) and its powers of attorney would be convenient for tax, employment, and social security purposes.

2. STEPS AND TIMING TO ESTABLISH

2.1 Corporation or Limited Liability Company

In general terms, Companies (SA or SL, herein after "NEWCO") shall be incorporated by means of (i) granting the incorporation notary deed by shareholders, (ii) obtaining a Tax ID number; and (iii) registering the company into the commercial registry.

- **Documents to be obtained before the signature of the incorporation deed of a corporation or a Limited Liability Company**

- *Name of the NEWCO:* certificate of the Central Commercial Registry about the name of the NEWCO.

- *Cash contributions:* To open a bank account and to obtain a bank certificate indicating that the shareholders have deposited the funds to pay in the capital.

  In case of SL, it is not compulsory to prove that cash contributions have been made if shareholders state at the incorporation deed that they will be joint and severally liable for these cash contributions against the company and creditors.

- *By-Laws*

- *Shareholders and Directors of NEWCO: NIE or NIF:* The Spanish legislation requires that any individual or legal entity with economic or professional interests in Spain, or involved in a relevant way for tax purposes, must hold a Tax Identification Number "NIF" (in the case of legal entities) or a Foreigner Identity Number "NIE" (for individuals). In particular, and among other cases, a NIF/NIE must be applied for when a foreign investor makes a direct investment in Spain or in case of a shareholder or director of an entity resident in Spain.

- *Power of attorney:* in case the shareholder does not come to Spain at the incorporation execution deed.

- **Execution of incorporation deed before a notary**

Shareholders or their duly authorised representatives shall execute the incorporation deed, which includes:

- *By-laws.*

- *Evidence of cash contributions, when applicable as indicated before, or contributions in kind.*

- *Appointment of directors: directors shall accept their appointment before the notary, by letter of acceptance or through a dully authorised representative.*

- *Final beneficial owner identity: pursuant to anti-money laundering and terrorist financing regulations funders shall provide the identity of the beneficial owner, being understood as: (i) individuals holding directly or indirectly over 25% of the capital or voting rights; or (ii) exercise directly or indirectly the control of NEWCO. When nobody holds such participation or exercises such control, it is considered to be the directors who exercise such control. In case any of the directors is a legal entity, the individual representing that entity is considered to exercise the control.*

- **Tax filings**

- *Tax Identity Code ("NIF) for the NEWCO:* a provisional NIF shall be obtained prior to filing at the Commercial Registry, and once NEWCO is registered the final NIF will be provided by Tax Authorities (the number does not change).
- *Registering in the Tax Census:* NEWCO shall be registered into the Census of Traders, Professionals and Withholding Agents ("Censo de Empresarios Profesionales y Retenedores") before initiating the activity.
- *NEWCO shall file tax return on Economic Activities Tax ("Impuesto de Actividades Económicas"):* there is an exemption for the two first tax years and while the turnover is lower than 1 million.
- *Incorporation of a company is taxed on Transfer Tax as exempt (tax on corporate events concerning transaction on company's equity):* transfer tax return shall be filed.

- **NEWCO registering in the Commercial Registry**

NEWCO can initiate its activities as from the date stated at the incorporation deed, but it will become a legal entity with legal personality separated from its shareholders upon registration.

2.2 Branch

In general terms, a Branch shall be incorporated by means of (i) granting the incorporation deed by parent company before a notary, (ii) obtaining a NIF (Tax ID); and (iii) registering the branch with the Commercial Registry.

- **Documents to be obtained before the signature of the incorporation deed of a Branch**

- *Resolution incorporating the branch passed by the parent company:* The resolution to open a branch and to grant power of attorney to its representative shall be passed by the competent body of the foreign parent company. This resolution shall be translated into Spanish.
- *Cash contributions:* To open a bank account to allocate the contribution, if any.
- *Parent company's NIF and appointment of its representative in dealings with the Spanish tax authorities:* Foreign investor shall apply for a NIR and appoint an individual or legal entity residing in Spain to represent him in dealings with the Spanish tax authorities regarding its tax obligations.
- *Obtaining the NIF/NIE of the branch directors:* Foreign Directors or attorneys-in-fact of the branch shall also hold a NIE/NIF.
- *Power of attorney:* in case the parent company representative does not come to Spain at the incorporation execution deed.

- **Public deed of incorporation:**

Parent company or its duly authorised representatives shall execute the public formalization before a notary of the resolution to open a branch, previously adopted by the competent body of the foreign parent company. The notary will request the following documents or points that shall be incorporated to the deed:

- Evidence of the identity of the person who appears before the notary, his power of attorney to represent the parent company.

- Resolution incorporating the branch passed by the competent body of the Parent company (documents shall be translated, legalized and/or certified by apostille, as appropriate).
- Evidence of the existence of the Parent company, its bylaw and name and personal details of its directors (documents shall be translated, legalized and/or certified by apostille, as appropriate).
- Evidence of cash contributions or contributions in kind (if applicable).
- Appointment of the branch's directors and authorities granted to them.
- Name, activity, and registered office of the branch.
- Final beneficial owner identity: as mentioned earlier for companies.

- **Tax filings**

- Tax Identity Code ("NIF) for the Branch: a NIF shall be obtained prior to filing at the Commercial Registry. To apply for it, the representative of the branch shall also hold a NIE/NIF.
- Registering in the Tax Census: as mentioned earlier for companies.
- The Branch shall file tax return on Economic Activities Tax ("Impuesto de Actividades Económicas"): as mentioned earlier for companies and except a Tax Treaty sets forth the exemption.
- Opening of a branch is taxed on Transfer Tax (tax on corporate events concerning transaction on company's equity), except when the parent company is an EU Company or is a company with a registered office located within EU and its center of effective management is locates out of EU.

2.3 Acquisition of a Shelf Company

To acquire a Shelf Company accelerates the process of starting a business, but it is more expensive. In order to acquire a shelf company, the following steps and documents are required:

- **Execution of sale and purchase of shares deed before a notary**

Foreign investors or their duly authorised representatives shall execute the acquisition deed. Following documents shall be required:

- The title of ownership of the shares transferred.
- Buyer´s and Vendor´s NIE/NIF.
- Documentary evidence of the payment and how it was made.
- Final beneficial owner statement.
- If the deed is granted abroad, it shall be dully legalized.

- **Execution of corporate changes and director's appointment deed and registering with the Commercial Registry.**

- **Tax filings**

- It is basically the same as when incorporating a company, except applying for a NIF because the company already has it.
- Generally speaking, sale and purchase of shares is tax-exempt on Transfer Tax, except for certain transactions involving indirectly transfer of real estate properties: transfer tax return shall be filed.

3. GOVERNANCE, REGULATION AND ONGOING MAINTENANCE

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

See chart attached (***Annex 1***) as a summary of the main regulations of each type of company and a branch.

3.2 Requirements for local shareholding/directors

- **Shareholders and directors**

There are no general requirements for any shareholders and directors, except for specific sectors or activities where law provides specific requirements as to hold licences or authorizations for such activity. Shareholders and directors may be of any nationality.

- **NIE or NIF**

Both, shareholders (parent company in case of branch) and directors shall hold a Tax ID number (NIE or NIF). Furthermore, in case of a branch, the parent company will have to appoint a representative residing in Spain for tax purposes.

- **Residence permit**

A residence permit will be required when the foreign shareholder or foreign director resides in Spain. There are different resident permits, some of them also allows to work. So, the permit to apply for shall be analysed in a case-by-case basis.

3.3 Minority shareholders' rights and protection

See chart attached (***Annex 2***) as a summary of the main minority shareholders' rights.

4. FOREIGN INVESTMENT, THIN CAPITALISATION, RESIDENCY AND MATERIAL VISA RESTRICTIONS

4.1 Any significant barriers to entry for an offshore party

In general terms, there are not significant barriers to entry for an offshore party, except in regulated sectors (the main ones are: financial, insurance, energy and Technology, media, and telecommunications).

4.2 Any capitalisation obligations

Companies shall keep its net worth higher than half of the share capital. So, if losses reduce the net worth of the company below half of the capital (generating a "non-balance net equity" position), the company is obliged either:

- to increase or reduce the capital in order to meet that threshold, or
- to be dissolved.

To this extent, participation loans shall be considered equity.

Directors of the companies shall call the meeting to pass such resolutions. When directors fail to do so, become liable of the debts accrued after the non-balance net equity position occurs.

As an exception, due to the public health crisis context caused by COVID-19 losses of tax year 2020 will not compute to calculate the non-balance net equity position and directors' liability shall not apply when dissolution cause occurred during COVID-19 state of alert.

In case of a corporation, the law provides a mandatory capital decrease when, for more than one tax year, losses reduce the net worth of the company below two-thirds.

4.3 Any special business or investment visa issues

- **Foreign investments subject to report**

Non-resident investments are free, but they shall be reported to the Directorate-General for International Trade and Investments (DGCI "Dirección General de Comercio Internacional e Inversiones") for statistical and tax purposes. Only when the investment comes from a tax heaven and exceeds 50% of the NEWCO's capital a prior declaration to make the investment is required.

- **Restriction due to COVID-19**

As an exception, due to the public health crisis context caused by COVID-19 and the resulting economic vulnerability certain foreign investment have been restricted:

- Direct investments in listed companies, or in non-listed companies when the investment value exceeds 500 million euro.
- When affects Spanish strategic sectors; or
- When the investor is controlled by a third-country government; or
- When the investor participates in sectors that affect public order, public security, and public health; or
- When the investor has had administrative, or court proceedings brought against him/her in another States for criminal or unlawful activities.

This restriction affects to investors who are non-EU-EFTA residents or when being EU-EFTA residents its beneficial owner are non-residents, and which holds at least 10% of the capital of the company or control the company. This restriction shall apply until December 31, 2021.

- **Monitoring of foreign investments**

DGCI can generally or specifically require Spanish companies which have foreign shareholders, and Spanish branches of non-resident persons, to file an annual report with it on the status of their foreign investments. The DGCI may also require the holders of investments to provide the information necessary in each particular case.

- **Foreign transactions declarations with the bank of Spain**

Bank of Spain establishes that individuals or entities (public or private) resident in Spain, other than payment service providers registered on the official registers of the Bank of Spain, that carry out transactions with non-residents or hold assets or liabilities abroad, must report them to the Bank of Spain ("Banco de España"). This report has purely statistical and informative purposes.

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

- **Non-residence Income Tax: Dividends and branch's profits, Interest and Capital Gains (coming from the dissolution of the subsidiary or closing of the branch): Non-residence Income Tax**

These source of incomes will be taxed in Spain depending on the country of residence of the offshore parent company:

⇨ If it is resident in a non-EU country with which Spain does not have a tax treaty: income will be taxed in Spain at a rate of 19%.

⇨ If it is resident in a non-EU country with which Spain does have a tax treaty (provided that there is reciprocal treatment):

- Dividends / branch's profits: dividends will be taxable at the reduced treaty

rate and the remittance of branch's profits will, under most treaties, be exempt from tax in Spain. In general terms, tax treaties signed by Spain set forth a dividends taxable rate in the range of 5 to 15% and, in case of Parent-Subsidiary dividends in the range of 5% to 10%, provided that the parent company holding in the subsidiary reaches mostly a percentage in the rate of 10%-to 25% (50% in some cases).

- Interest: will be taxable at the reduced treaty rate, mostly at the rage of 0-10%.
- Capital Gains coming from the subsidiary's dissolution or the branch's closing: tax treaty shall apply: Usually double taxation treaties provide that capital gains from a dissolution of a subsidiary or the closing of a branch shall be taxed in the country where the parent company earning the capital gains is located, except when real property assets located in Spain are involved, allowing then to be taxed also in Spain.

⇨ If it is EU-resident (except tax heaven):

- Dividends / branch's profits are usually tax-exempt. If the exemption cannot be applied to dividends, the reduced rate under the relevant tax treaty with Spain will apply. If there is no tax treaty with Spain and the exemption cannot be applied, the applicable rate will be 19%.
- Interest: interest paid are tax-exempt.
- Capital Gains coming from the subsidiary's dissolution or the branch's closing: tax treaty shall apply is usually tax-exempt. If requirements for exemption are not met, the reduced rate under the relevant tax treaty with Spain will apply. If there is no tax treaty with Spain and the exemption cannot be applied, the applicable tax rate will be 19%.
  - Closing a Branch or dissolving a subsidiary is also taxed by Transfer Tax at the rate of 1% on the market value of goods and rights refunded to the parent company, except when the parent company is an EU Company or is a company with a registered office located within EU and headquarters (center of effective management) is located out of EU.

- **Withholding tax**

- Taxable Incomes (profits, dividends, interest, stock refunding) paid by the subsidiary or branch to the parent company taxable in Spain shall be subjected to withholding tax at a rate of:
  - 19%; or
  - at the reduced Double Taxation Treaty rate, if applicable.

Tax-exempt Incomes: shall be not subjected to withholding tax.

ANNEX 1: GOVERNANCE, REGULATION AND ONGOING MAINTENANCE

	SA	SL	BRANCH
CAPITAL & SHAREHOLDER			
Number of Shareholders	▶ Minimum 1. ▶ Individuals or legal entities.	▶ Minimum 1. ▶ Individuals or legal entities.	N/A.
Minimum Capital	€ 60,000	€ 3,000	No minimum.
Divided into	▶ Registered shares. ▶ Bearer shares. ▶ Can be negotiated on the stock market.	▶ Quota (not-negotiable interest). ▶ Cannot be negotiated on the stock market.	N/A.
Payment upon formation	25% of the face value is the minimum payment on incorporation. The rest shall be contributed according to the agreed terms. In case of non-capital contributions within 5 years.	Fully paid up on incorporation.	N/A.
Contribution in kind	The value of the contribution in kind requires the assessment of an independent expert.	Partners are jointly and severally liable for the value of the contribution in kind. In case of increase of capital, directors are liable. No expert assessment is required.	N/A.
Voting rights	No privileges are allowed to alter the principal of one share one vote.	Privileges are allowed making easier to change the voting rights principal of 1	N/A.

	SA	SL	BRANCH
	However, shares without voting rights are allowed.	share 1 vote. Shares without voting rights are also allowed.	
FINANCING SOURCES			
Listing and issuing bonds or other negotiable instruments	Can issue shares and bond or debt interest, including bonds convertible to shares.	Quotas representing the capital are not marketable securities. Debentures and other securities that recognize or create a debt can be issued. The total sum issued by a limited liability company may not exceed double their own resource value, unless the issue is guaranteed by mortgage, securities pledge, government guarantee or joint guarantee from a credit entity. Cannot issue or guarantee bonds convertible into quota.	N/A.
CORPORATE GOVERNANCE			
General shareholders meeting	▶ Jurisdiction: It is under the jurisdiction of the general meeting to deliberate and decide on the following matters: - Approval of annual financial statements, distribution of earnings and the approval of corporate governance. - Appointment and dismissal of	▶ Jurisdiction: It is under the jurisdiction of the general meeting to deliberate and decide on the following matters: - Approval of annual financial statements, distribution of earnings and the approval of corporate governance. - Appointment and dismissal of	N/A.

	SA	SL	BRANCH
	directors, liquidators and, when necessary, account auditors and the institution of liability action against any of these persons. - Amendments to by-laws. - Capital increase and reduction. - Removal or limitation of pre-emptive or preferential subscription rights. - Acquisition, disposal, or transfer to another company, of any essential assets. Assets are considered essential when the sum of the transaction exceeds twenty-five percent of the share value shown in the latest approved balance sheet. - Conversion, merger, spin-off or global assignment of assets and liabilities and transfer of registered office abroad. - Dissolving the company. - Approval of the final liquidation balance sheet. - Any other matters stipulated by the law or the by-laws.	directors, liquidators and, when necessary, account auditors and the institution of liability action against any of these persons. - Amendments to by-laws. - Capital increase and reduction. - Removal or limitation of pre-emptive or preferential subscription rights. - Acquisition, disposal, or transfer to another company, of any essential assets. Assets are considered essential when the sum of the transaction exceeds twenty-five percent of the share value shown in the latest approved balance sheet. - Conversion, merger, spin-off or global assignment of assets and liabilities and transfer of registered office abroad. - Dissolving the company. - Approval of the final liquidation balance sheet. - Any other matters stipulated by the law or the by-laws.	

	SA	SL	BRANCH
Managing body	▶Types: the management of the company may be entrusted to: - a sole director, - several directors who may act jointly or jointly and severally; or - a Board of Directors. ▶Term of the post: cannot be longer than 6 years, but directors can be re-elected one or more times for terms of the same duration.	▶Types: the management of the company may be entrusted to: - a sole director, - several directors who may act jointly or jointly and severally; or - a Board of Directors. Members of the Board of Directors in this case are limited to 12. ▶Term of the post: will be unlimited, unless otherwise foreseen in the by-laws of the company.	▶Representative resident in Spain, who acts as attorney of the branch in the name and on behalf of the parent company for all purposes, particularly tax purposes. The attorneys in fact of the branch are appointed by the parent company. ▶Term of the power of attorney: the parent company usually grants the power of attorney without a limit of time that can be cancelled at any time by the parent company.
REPORTING REQUIREMENTS			
Annual accounts and reports	Company must keep proper accounting records to show transactions and current financial position of the company. Financial statements shall be: ▶Drafted clearly and present a true and	Company must keep proper accounting records to show transactions and current financial position of the company. Financial statements shall be: ▶Drafted clearly and present a true and	Non-residents who operate in Spain through a permanent establishment (Branch) are generally required to keep accounting records in Spain, in accordance with the rules and procedures established for Spanish companies. Foreign company's financial statements: ▶Drafted according to its local law. If it

	SA	SL	BRANCH
	fair view of the company's net worth, financial position, and net income;	fair view of the company's net worth, financial position, and net income;	is not required to prepare, have audited, and publicly disclose accounts according to local law or it is obliged in non-equivalent manner to the Spanish legal provision, it is still required to file accounts concerning branch activity in Spain as if it was subject to Spanish Law.
	▶ Filed with the Commercial Registry; and	▶ Filed with the Commercial Registry; and	▶ Filed with the Commercial Registry: - Branch financial statements - Foreign company financial statements
	▶ Audited, except when two of the following requirements are met on the closing date of two consecutive tax years: - Their assets do not amount over €2,850,000. - Their net yearly turnover is not in excess of €5,700,000. - Their average number of employees during the year is not over 50.	▶ Audited, except when two of the following requirements are met on the closing date of two consecutive tax years: - Their assets do not amount over €2,850,000. - Their net yearly turnover is not in excess of €5,700,000. - Their average number of employees during the year is not over 50.	

ANNEX 2: MINORITY SHAREHOLDERS' RIGHTS

RIGHT	SA	SL
Right to attend meetings	The by-laws may subject eligibility to attend the general meeting to ownership of a minimum number of shares (never greater than 1/1000 of the share capital).	All members are entitled to attend the general meeting. The by-laws may not make attendance at general meetings contingent upon ownership of a minimum number of stakes.
Right to request to convene a meeting	Shareholders holding at least 5% of the share capital.	Members holding at least 5% of the capital.
Information Right	Shareholders may request, from directors, any information or clarification they deem necessary regarding the items on the agenda of the meeting. Directors shall be obliged to provide the requested information, unless said information be deemed unnecessary for the recognition of the shareholders' rights or there be objective reasons to consider that it may be used for reasons detrimental to the company's best interests or where publication of the same may prejudice the company or associated companies. Information may not be withheld when requested by partners representing at least 25% of the capital.	Members may request, from directors, any information or clarification they deem necessary regarding the items on the agenda of the meeting. Directors shall be bound to provide such reports or clarification except where, in the governing body's opinion, disclosing such information may be detrimental to the company's interests. Information may not be withheld when requested by partners representing at least 25% of the capital.
Financial Statements and accounting Information Right	Any shareholder is entitled to obtain the documents that have to be submitted to the general meeting for financial statements approval, and, as appropriate, the management	Any member is entitled to obtain the documents that have to be submitted to the general meeting for financial statements approval, and, as appropriate, the management

RIGHT	SA	SL
	and auditor's reports.	and auditor's reports. Any member holding at least 5% of the capital, may examine (with an expert accountant) the accountancy and documents substantiating the financial statements, unless otherwise provided in the by-laws.
Appointing auditor (when is not mandatory)	Shareholders representing at least 5% of the share capital are entitled to request auditor appointment to audit the financial statements for a specific financial year.	Members representing at least 5% of the share capital are entitled to request auditor appointment to audit the financial statements for a specific financial year.
Right to proportional representation at the Board of Directors	Shares that are voluntarily grouped to constitute share capital amounting to or exceeding the sum resulting from dividing the capital by the number of members of the board of directors, shall be entitled to designate the number of members deduced from the proportion of share capital so grouped, rounding any fractions.	Unless provided in the by-laws, minority partners cannot be represented in the board in proportion to their stake in the company.
To challenge company resolutions	Shareholders representing either individually or jointly, at least 1% of the share capital are entitled to challenge company resolution (subject to challenge according to law). The by-laws may reduce the mentioned percentage.	Members representing either individually or jointly, at least 1% of the share capital are entitled to challenge them (subject to challenge according to law). The by-laws may reduce the mentioned percentage.
Right to exit the company	Shareholders not voting in favor of the respective resolution, including non-voting shareholders, shall be entitled to exit the company in any of the following circumstances: - Supersession or amendment of the corporate purpose. - Extension of company term.	Members not voting in favor of the respective resolution, including non-voting partners, shall be entitled to exit the company in any of the following circumstances: - Supersession or amendment of the corporate purpose. - Extension of company term.

RIGHT	SA	SL
	- Company reactivation. - Creation, amendment, or early cancellation of ancillary commitments, unless otherwise provided in the by-laws. - Company conversion into a different type of company and relocations of the registered office abroad. The by-laws may establish causes for exit other than provided in Law.	- Company reactivation. - Creation, amendment, or early cancellation of ancillary commitments, unless otherwise provided in the by-laws. - Company conversion into a different type of company and relocations of the registered office abroad. - Amendment of shares transfer rules. The by-laws may establish causes for exit other than provided in Law.
Right of exit due to failure to distribute dividends (not applicable in listed companies).	Unless otherwise provided in by-laws, after the fifth year from the date of the company's registration on the Companies Register, any shareholder who voted in favor of distributing dividends shall have the right to exit, in the event that the general meeting does not agree to distribute at least 25% of the legally distributable profits arising from the company's main business activities during the previous financial year. Nevertheless, this right to exit shall not be triggered when total of dividends distributed during last 5 years amount at least 25% of the of the legally distributable profits arising from the company's main business activities during such 5 years period. COVID 19: This right has been suspended until December 31 2020	Unless otherwise provided in by-laws, after the fifth year from the date of the company's registration on the Companies Register, any partner who voted in favor of distributing dividends shall have the right to exit, in the event that the general meeting does not agree to distribute at least 25% of the legally distributable profits arising from the company's main business activities during the previous financial year. Nevertheless, this right to exit shall not be triggered when total of dividends distributed during last 5 years amount at least 25% of the of the legally distributable profits arising from the company's main business activities during such 5 years period. COVID 19: This right has been suspended until December 31 2020

Fall 21

INTERNATIONAL LAWYERS NETWORK

HELLSTRÖM

ESTABLISHING A BUSINESS ENTITY IN SWEDEN

ILN CORPORATE GROUP

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 are legally responsible for 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 25 000 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's 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 Hellström Law establishes for a client are Aktiebolag, i.e., Limited Liability Companies. It is the predominant way forward for all businesses in Sweden and a very flexible and well-regulated association. In order to form a Limited Liability Company, the founders (shareholders) must initially 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, or 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 may offer this service to you.

With regards to residency (note, not citizenship), the 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 for the company within matters concerning the day-to-day business.

For practical reasons, it is common that signatory powers are assigned to one or more individual board member that is authorized to sign for the company alone or jointly together with another board member (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

Sole traders are not required to register with the Swedish Companies Registration Office, however if you choose to do so, the name of the business gains 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 in order to be able to register as a sole trader. A co-ordination number is obtained from the Swedish Tax Agency and is used in your registration application with the Swedish Tax Agency. Furthermore, you must provide a copy of your passport or other identity documentation and the minimum age limit is 16 years.

If you are registered in a country outside the European Economic Area (EEA) you must appoint a manager for your business to be 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 resident in Sweden, have a Swedish identity number and be at least 18 years old.

As a sole trader, you are the one that is authorized to sign on behalf of the company.

Trading Partnership

To be able to establish a trading partnership, the partners must enter into 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 be in writing, an oral agreement is also valid (but less advisable).

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 his/her passport or other official identity document with the application, in order to be registered with the Swedish Companies Registration Office.

Each partner is authorized to sign on behalf of the company unless otherwise agreed. An outside party can be appointed to sign on behalf of the company; however, this party cannot be registered as the only person who is authorized to sign on behalf of the partnership. This means that at least one partner must always be authorized to sign on behalf of 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, in addition to the aforementioned, it is also required to file a certificate of registration that is not older than six months and that states the authorized signatory/-ies together with the application.

Limited Partnership

As applies to trading partnerships, partners who wish to establish a limited partnership must enter into an agreement to jointly carry out business activities. If the agreement is in writing it must be signed by all partners. Since it is not considered 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 be in writing, an oral agreement is valid (however normally not advisable).

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 his/her 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. If the partner is a foreign legal entity, a certificate of registration that is not older than six months, that states the authorized signatory/-ies of the company, must be filed together with the application.

As stipulated above, there must be at least one general partner and one limited partner in a limited partnership. It is important to be aware of those general partners have unlimited liability for the company's debts whilst the limited partners are only liable for the capital (if any) that they have contributed with.

The general partner is authorized to sign on behalf of the company. If there is more than one general partner, each partner is authorized to sign on behalf of the company unless

otherwise agreed. A limited partner is not authorized to sign on behalf of the company.

As also applies to trading partnerships, an outside party can be appointed to sign on behalf of the company, however this party cannot be registered as the only person who is authorized to sign on behalf of 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 any other agreements that they enter into.

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 regarding the nationality of a shareholder or to the number of shareholders.

It is a requirement for a private limited liability company to have a board of directors.

The board of directors must consist of one or more directors. The number, or the lowest and highest number, of directors in the board shall be regulated in the articles of association. If the board consists of less than three ordinary directors, at least one deputy director shall be appointed. At least half of the board members and at least half of the deputy board members must me resident 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, by law, has authority to sign for the company in day-to day matters.

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 seeking to offer 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.

The partners represent the company and acts 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, as stated in the partnership agreement, all the partners must agree on it.

Detailed rules regarding the partnership's 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 partnership's 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, amongst other rules 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 enters 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 support 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 require 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/her 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 have 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 on 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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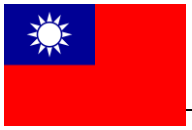
ESTABLISHING A BUSINESS ENTITY IN TAIWAN

ILN CORPORATE GROUP



ESTABLISHING A BUSINESS ENTITY IN TAIWAN

Introduction to Taiwan

In less than 50 years starting from 1949, Taiwan went from an agriculture-based economy to be an economic powerhouse and leader in the field of high-tech goods. Its Gross Domestic Product (GDP) grew from US$1.2 billion in 1951 to US$589.5 billion in 2018. According to the World Trade Organization, in 2018, Taiwan was the 18th largest exporter and 17th largest importer of goods in the world. In terms of services, Taiwan ranked 27th and 26th for the export and import of commercial services, respectively. In the same year, its services sector accounted for nearly 63.19% of its GDP, while manufacturing and construction accounted for 30.77% and 2.52%, respectively. Taiwan, as a leader in the information and communications technology industry, is one of the world's largest semiconductor, computer, and mobile phone providers, and one of the world's largest producers of computer monitors.

1. Types of Business Entities

- **Description of the types of entities available in each jurisdiction through which to conduct business**

There are various legal forms for business that foreign entities can use to do business in Taiwan. We set out below a general and brief introduction to various forms of business entities under the Company Act, last amended on August 1, 2018, that foreign investors may choose from to do business in Taiwan. If a foreign investor desires to do business in Taiwan, it may establish a branch office or a new company.

Limited company

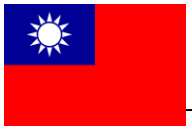
A limited company is a close company with one or more shareholders, and its capital is paid up by its shareholders. A limited company is managed by the directors elected by the shareholders and the profits are shared among the shareholders. The liability of shareholders is limited to the extent of the capital contributed by each of them, except where the shareholder abuses the company's status as a legal entity thereby causing the company to bear specific debts.

Company limited by shares

A company limited by shares must be organized by two or more shareholders, except where the company is incorporated by a single corporate or governmental shareholder. A company limited by shares may choose to issue all of its shares either with or without a par value. For the former, the capital of the company should be divided into shares of the same par value (other than preferred shares). For the latter, the amount paid for subscribing to such no-par value shares shall be fully set aside as equity capital, and the company may not convert the shares into par value shares. The liability of shareholders shall be limited to payment in full of the shares they have subscribed. Most foreign investors operate through companies limited by shares in Taiwan.

Branch

A branch office is an extension of a foreign company conducting business in Taiwan. A branch office must be duly established before a foreign company conducts business in Taiwan in its name. Since a branch office is not an independent legal entity but a part of the foreign company, all the liabilities of the branch will be extended to the foreign head office if the assets of the branch are not sufficient to satisfy all its indebtedness.



Closely held company

A closely held company is a private company limited by shares which may stipulate in its articles of incorporation a restriction on share transfer and can only have no more than 50 shareholders. A closely held company is a new corporate form added under the amendments to the Company Act on June 15, 2015. Closely held companies are designed to encourage the growth of startups, particularly tech startups and small and medium enterprises, by granting more flexibility in operating the companies. Since this entity form is seldom used by foreign investors, we will focus on the limited company, company limited by shares and branch below.

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

Various factors should be taken into consideration when determining the entity type to use, including tax, the kind of business to be operated in Taiwan, etc. Although there is no strict rule, a few points below may be noted.

Generally speaking, compared to a branch, a subsidiary (either a limited company or company limited by shares) is subject to more tax burden in Taiwan such as withholding income tax on dividend repatriated to the foreign shareholders and retained earnings tax, and more corporate formalities such as the requirement to hold an annual meeting of shareholders.

On a separate note, a foreign entity may acquire real property if and when necessary for the business operations of its Taiwan branch, provided that its home country shall grant the same rights and privileges to Taiwanese nationals and companies. In addition, approval of the Ministry of Interior must be obtained before the foreign company acquires real property. This approval requirement does not apply to a subsidiary as it is a Taiwanese company.

2. Steps and Timeline to Establish

- **Brief overview of steps to incorporate/constitute each**

Branch

Briefly speaking, to establish a branch office in Taiwan, the foreign company should file an application with the Ministry of Economic Affairs (MOEA) to apply for branch registration. Subsequently, the branch must apply for business registration and tax registration before it may start conducting business in Taiwan. Usually, it will take about 5 to 7 weeks to complete all the registrations.

The branch office is required to appoint a branch manager as well as a representative to represent the foreign company (can be the same person). If the branch manager and/or the representative is a foreigner, a work permit and an Alien Resident Certificate should be obtained before he/she can work in Taiwan pursuant to the Employment and Service Act.

Limited company

A limited company must have at least one shareholder. There is no nationality restriction on the shareholder(s). If any of the shareholders is a foreign national, it must apply with the Investment Commission (IC) for foreign investment approval. Then, the foreign investor should file an application with the MOEA to apply for incorporation registration.

There is no minimum capital requirement, but the capital of a limited company must be fully paid up by the shareholders; the capital

cannot be paid in installments. A limited company can determine any capital amount as long as such amount is sufficient to cover the cost of the incorporation of the company. An audit report issued by a certified public accountant (CPA) is required when the company applies for the incorporation registration. However, certain regulated businesses may require a minimum amount of capital. In addition, if such company intends to hire expatriates other than the general manager to work in Taiwan, the minimum paid-in capital should be NT$5,000,000. If the paid-in capital amount is insufficient to cover the cost of the incorporation of the company, the government authority will not approve the incorporation registration.

If the company engages in a manufacturing business, it must complete the registration of its factory before it may commence the manufacturing and processing of its products.

Usually, it will take about 7 to 8 weeks to complete the IC approval and registrations described above.

Company limited by shares

A company limited by shares is required to have at least one corporate or two individual shareholders as its promoters. The company must first reserve a corporate name with the MOEA. If any of the shareholders is a foreign national, it must apply with the IC for foreign investment approval. Then the shareholders must subscribe to the shares and pay the subscription price. For a company with more than one shareholder, the promoters are required to convene a shareholders' meeting to elect the director(s) and the supervisor(s). If a company has only one corporate shareholder, the sole shareholder must appoint representatives to act as the director(s) and supervisor(s). The director(s) so elected or appointed must then hold a board meeting to elect a person from among themselves to serve as the chairman of the board. In addition, a business registration and tax registration must be filed with the local tax authority before the company may commence its business operations. The capital requirement for limited companies as mentioned above also applies to a company limited by shares. Similarly, if the company engages in a manufacturing business, it must complete the registration of its factory before it may commence the manufacturing and processing of its products.

Usually, it will take about 7 to 8 weeks to complete the IC approval and registrations described above.

3. Governance, Regulation and Ongoing Maintenance

- **Brief summary of regulation of each type and ongoing maintenance, reporting requirements**

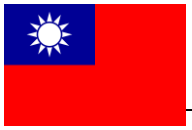
Limited company

Directors

A limited company must have at least one and not more than three directors elected by two-thirds or more of the shareholders from among themselves to conduct business and represent the company. If there is more than one director, the articles of incorporation of a limited company may stipulate that a chairman be elected from among the directors by a majority of the directors, to be the responsible person of the company. There is no requirement for a limited company to hold meetings of board of directors.

Financial audit

At the end of each fiscal year, the directors shall prepare the following statements and



records and shall send the same to each shareholder for approval:

a. business report;

b. financial statements; and

c. proposal for earnings distribution or making up losses.

If a company has paid-in capital of NT$30,000,000 or more, net operating revenues of NT$100,000,000 or more, or hires one hundred or more employees with labor insurance coverage, its financial statements must be audited and certified by a CPA.

If no objection is raised by any shareholder within one month, the statements and records shall be deemed to have been approved by all shareholders.

Annual reporting

A company shall report annually the names, nationalities, birthdays, or the dates of its incorporation registration, identification numbers, capital contribution, and other items as required by the central competent authority of its directors, supervisors, managerial officers, and shareholders holding more than 10% of the paid-in capital of the company to the information platform established or designated by the central competent authority by way of electronic transmission. If there is any change to the above items, the company shall, within 15 days after such date of change, report such change to the information platform.

Company limited by shares

Directors and supervisor(s)

A company limited by shares shall have at least three directors to form its board of directors and one supervisor. A company owned by a single corporate shareholder may have no supervisor and have one or two directors in lieu of the board of directors. A non-public company that is not owned by a single corporate shareholder may have one or two directors in lieu of a board of directors, if so, specified in its articles of incorporation, but it must have at least one supervisor. A company with a board of directors must elect a chairman of the board and may also elect managing directors, if the number of directors is more than nine, and the company may delegate certain functions to the board of managing directors. If a company so wishes, a vice chairman of the board may also be elected from among the directors at the board meeting.

Financial audit

At the end of each fiscal year, the board of directors shall prepare the following statements and records and shall forward the same to supervisors for their verification not later than 30 days prior to the date of a general meeting of shareholders:

a. business report;

b. financial statements; and

c. proposal for earnings distribution or make up losses.

The CPA audit requirement for limited companies as mentioned above also applies to a company limited by shares.

The board of directors shall submit such financial statements and records to the general meeting of shareholders for recognition. Once the documents are recognized, copies of recognized financial statements and the resolutions on the proposal for earnings distribution or making up losses shall be distributed to each shareholder.

Shareholders' meeting

Only companies with more than one shareholder have shareholders' meetings; in the case of single-shareholder companies, the functions of shareholders' meetings are assumed by board meetings. A general meeting of shareholders must be convened within six months after close of each fiscal year, unless otherwise approved by the competent authority for good cause shown. Special meeting of shareholders may be held when necessary.

Annual reporting

A company shall report annually the names, nationalities, birthdays, or the dates of its incorporation registration, identification numbers, numbers of shareholding, and other items as required by the central competent authority of its directors, supervisors, managerial officers, and shareholders holding more than 10% of the total shares of a company to the information platform established or designated by the central competent authority by way of electronic transmission. If there is any change to the above items, the company shall, within 15 days after such date of change, report such change to the information platform.

- **Requirements for local directors/supervisors**

There is no nationality or residence restriction on the directors and supervisors except that a People's Republic of China (PRC) national cannot act as either a director or supervisor of a Taiwanese company. The supervisor cannot be a director, an employee, or a managerial officer of the company.

- **Minority shareholders' rights and protection**

Limited Company

Supervision

Each of the shareholders who does not conduct business (i.e., not being a director) may exercise the right of supervision to request the company to provide information on the business condition of the company and examine its assets, documents, books, and statements from time to time.

Company limited by shares

Right to make a proposal at the annual shareholders meeting

Shareholders holding 1% or more of the issued and outstanding shares of a company are entitled to submit one written proposal each year for consideration at the annual general shareholders' meeting in accordance with the requirements under the Company Act.

Right to convene a shareholders' meeting

Shareholder(s) continuously holding 3% or more of the total issued and outstanding shares in a company for a period of one year or longer may, by means of a written proposal with reasons stated therein, request the board of directors to convene a shareholders' meeting. If the board of directors fails to give a notice for convening a shareholders' meeting within 15 days of receiving the request, the shareholders may apply to the local government for permission to convene a shareholders' meeting themselves.

Appraisal right

Dissenting shareholders are entitled to appraisal rights to ask the company to repurchase their shares at a fair market price in certain major corporate actions such as a proposed merger, amalgamation, or disposal of all or substantially all of the assets by the

company. If agreement on the fair market price cannot be reached, the company shall repurchase all of the shares from the dissenting shareholders at the fair market price acceptable to the company first and then seek a court order to determine the fair market price. Shareholders may exercise their appraisal rights by serving written notice on the company prior to or at the related shareholders' meeting and/or by raising and registering an objection at the shareholders' meeting.

Right to cancel shareholders' resolutions

Shareholders have the right to sue for the annulment of any resolution approved at a shareholders' meeting where the procedures were legally defective within 30 days after the date of the shareholders' meeting. However, if the court is of the opinion that such violation is not material and does not affect the result of the resolution, the court may reject or dismiss the shareholder's lawsuit. If the substance of a resolution adopted at a shareholders' meeting contradicts any applicable law or regulation or the articles of incorporation of the company, a shareholder may bring a suit to determine the validity of such resolution.

Right to sue and remove directors or supervisors

One or more shareholders who have held 1% or more of the issued and outstanding shares of a company for a period of six months or longer may require a supervisor to bring a derivative action on behalf of the company against a director as a result of the director's unlawful actions or failure to act.

One or more shareholders who have held 3% or more of the issued and outstanding shares may institute an action with a court to remove a director/supervisor who has materially violated the applicable laws or the articles of incorporation of the company or has materially damaged the interests of the company if a resolution for removal on such grounds has first been voted on and rejected by the shareholders and such suit is filed within 30 days of such shareholders' meeting.

Right to review and receive financial reports and statements

The shareholder shall have the right to review and receive the annual financial reports and statements prepared by the board of directors, audited by the supervisor (s), and accepted at the shareholders' meeting.

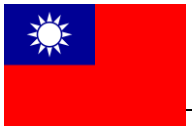
Right to inspect the business, accounts, property, particular item of the company

One or more shareholders who have held 1% or more of the issued and outstanding shares for six months or longer may request a court to appoint an inspector to examine the books, accounts, and financial conditions of the company. The court may, if it deems necessary based on the inspector's report, order the supervisor to convene the shareholders' meeting.

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

- **Any significant barriers to entry for an offshore party**

In 1988, the government of Taiwan promulgated a set of guidelines called the "Negative List", which was last amended on June 17, 2013. These guidelines set forth the sectors in Taiwan in which foreign investment is either restricted or prohibited. Sectors not on the Negative List are open to foreign investment without any restriction. Foreign investors are legally granted the right to remit their entire annual investment



return out of Taiwan. If a foreign investor transfers its investment upon government approval, the investor is guaranteed by law to repatriate 100% of its total equity investment.

According to Article 40-1 of the Act Governing Relations between the People of the Taiwan Area and the Mainland Area, a PRC entity is required to obtain approval from Taiwan competent authorities and establish a branch or representative office in Taiwan before it may conduct any business activities in Taiwan. Subject to the IC approval, PRC investors may also invest in a company in Taiwan. However, the business scope of Taiwan branch of a PRC-invested entity or the Taiwanese company invested by PRC investors shall be limited to the permitted businesses on the list promulgated by the IC from time to time.

- **Any capitalisation obligations**

In general, a branch/company (either a limited company or company limited by shares) is not subject to any minimum capital requirement as long as (i) its capital is sufficient to cover the costs and expenses for incorporating and operating the branch/company; and (ii) it does not operate any of the businesses to which specific minimum capital requirements applies. Please note that a branch/company must have paid-in capital of at least NT$500,000 if its branch manager/general manager is a foreign national and is on its payroll. If a branch/company wants to employ any foreign national other than the branch manager/general manager, it must have minimum paid-in capital of NT$5,000,000.

- **Any special business or investment visa issues**

According to the Employment Services Act, which was promulgated on May 8, 1992, and last amended on November 28, 2018, no foreign national may work in Taiwan without a work permit, which must be applied for by his/her employer. The employer may apply to the competent authority for a work permit for a foreign employee whose work falls within the prescribed categories, such as specialists and/or technical personnel, or officers in enterprises invested by foreign investors and duly approved by the IC.

- **Foreign exchange regulations**

Only certain inward and outward remittances, other than items (1) to (5) below and any inward or outward remittances exceeding the prescribed ceilings noted below, would require the approval of the Central Bank of the Republic of China (Taiwan):

(1) Inward and outward remittances for foreign trade in goods;

(2) Inward and outward remittances for services;

(3) Direct investments and portfolio investments approved by the competent authorities;

(4) Inward or outward remittances made by a company or firm of an aggregate amount not exceeding US$50 million in a calendar year, or by an organization or individual of an aggregate amount not exceeding US$5 million in a calendar year; and

(5) Inward or outward remittances made by a foreign individual who does not have an alien residence certificate or a person from a jurisdiction not recognized by Taiwan government as allowed to do business in the country, of an amount per transaction not exceeding US$100,000.

- **Withholding tax**

Since a branch is legally inseparable from its foreign company, net profits realized locally by the branch are considered profits of the foreign home company, and thus repatriation of such profits will not be subject to further withholding tax, while dividends declared by a subsidiary (either a limited company or company limited by shares) to its foreign shareholders shall be subject to a withholding income tax at the rate of 21% or a lower tax treaty rate if applicable.

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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.

  A Registered Ordinary Partnership which having 3 partners, or more may convert its legal entity to a private limited company. This will be subject to (i) prior consent have been granted by all partners; and (ii) no objection has been raised by its creditors. Unless said debts have been settled or placed with security in the case of objection was made by any creditor.

- **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. A limited partnership will also be able to convert its legal status to a private limited company and subject to certain conditions as mentioned in "**Registered Ordinary Partnership"**, above
- **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. Income Tax imposing on capital gain will be different when trading shares issued by a publicly listed company in the Stock Market of Thailand.
- **Joint Venture -** In Thailand, a Joint Venture is not a legal entity under the Civil and Commercial Code. If two parties both individual and corporate entity do enter into an agreement to work together as a Joint Venture, it is regarded to be a juristic entity under the Thai Revenue Code. A Joint Venture's income is subject to corporate income tax as a new entity and is required to obtain a new Tax I.D. under the Revenue Code.
- **Consortium –** A consortium is not a new legal entity under the Thai Civil and Commercial Code neither the Revenue Code. However, the consortium agreement is a kind of loose partnership, in which each party to the consortium is individually responsible for each work designated under the consortium agreement. Therefore, it does not need to have Tax I.D. and register as a value added tax operator. Each of the consortium party is responsible to pay tax based on profit and loss of its own entity and obtain necessary license.
- **Branch Office -** A Branch Office can only do business on behalf of a company based outside Thailand and must obtain a business license or a business certificate 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 (Rep-Office) can only engage in certain business activities on behalf of a company based outside Thailand, such as:
    - Finding a source for the purchase of goods or services in Thailand for the head office;

- Checking and controlling the quality and quantity of goods purchased or manufactured under hire in Thailand for the head office;
- Advising on various aspects concerning goods of the head office sold to agents or consumers in Thailand,
- Propagation of information concerning new goods or services of the head office; and
- Reporting on movements and trends of business in Thailand to the head office.

Under the new rules, it is required to report the establishment of a Rep-Office with the Ministry of Commerce instead of obtaining a business license under the Foreign Business Operation Act. A Rep-Office is a "non-trading unit" and cannot earn any income or profit under its own independent activities as notified to the said Authority. It can only obtain financial support from the overseas head office for its office expenditures in Thailand. A Rep-Office is considered a "tax unit" and as such it is required to register itself under the Thai tax system with the Thailand Revenue Office and must comply with all tax filing requirements such as withholding income tax, corporate income tax, etc.

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 Taxpayer 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 together with other required documents to the Department of Business Development (DBD) within one month from the date of shareholders meeting via the DBD's e-Filing system.

Note: e-Meetings have been implemented in Thailand for the first time under the Announcement of the National Council for Peace and Order No. 74/2557 (A.D. 2014). At this time, certain restrictions such as that 1/3 of the quorum must physically attend the meeting at the same venue and that all the attendees must be present in Thailand at the time the meeting is held have been repealed by the Emergency Decree on Electronic Meetings B.E. 2563 (A.D. 2020). Thus, any e-Meetings, whether board of directors' meetings or shareholder meetings, can be freely held, but must be in compliance with all related Thai laws.

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. The Thailand Revenue Department has now implemented its e-Filing system for all taxpayers, both individuals and juristic entities, to submit their related income tax applications via the Revenue Department's electronic system. More information is available at http://www.rd.go.th.

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.

Works Rules: An employer, when having employees altogether amounting to 10 persons or more, will be obligated to establish a "Work Rules" containing of specific provisions as required by law, announce and disclosure to employees at the working place within 15 days. Any non-compliance will be subject to a specific fine.

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 evidence.

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): wholesale and retail, specific services such as accounting and legal services, construction, agency, auction, hotels, and general services - subject to a business license. Non-restricted business includes manufacturing business, export business.

On June 13, 2019, Thai government has announced following Inter-companies servicing activities i.e., domestic loan provisions, office space rental services with public utilities, and consulting services specifically in the areas of administrative management, marketing, human resources, and information technology as exempted service businesses that foreign investors (individual/entity) can conduct without obtaining prior permission pursuant to the FBA. The businesses must be made between related juristic persons having one of the following relationships:

(a) More than half of the number of shareholders or partners in one juristic person are also more than half of the shareholders or partners in the other juristic person;

(b) Shareholders or partners that hold shares or are partners valued from 25% of the capital in one juristic person also hold shares or are partners with such value in the other juristic person;

(c) One juristic person that holds shares or is a partner with the value from 25% of the capital in the other juristic person; or

(d) More than half of the authorized directors or managing partners in one juristic person are also authorized directors or managing partners in the other juristic person.

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 or freely & without 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)[67];

(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

(iii) Being granted a business certificate for rendering each of 12 types of businesses, under Thai – Australia Free Trade Agreement.[68] This will be subject to certain qualifications, required proportion of shareholding between Thai and Australian investors and related conditions set for each type of such permitted businesses which including Mining (land and marine mining), Construction (Public Utilities Construction/ Transportation Construction that uses special equipment, machinery, technology or expertise), Hotel business (Luxurious hotel and resort service), Restaurant (Full range of restaurant), Other categories of Service Business (such as (i). General Consulting Service for ROH / branch or ROH's subsidiaries; (ii) Meeting Hall; (iii) International Product Exhibition Center; (iv) Wholesale and Retail service relevant to the sale and installation of the products manufactured by the Australian juristic person established in Thailand; (v) Education / Educational Institutes with science and technology expertise such as life sciences, bio – technology and nano technology; (vi) Fun Park and zoo service; (vii) Aquatic animal park service; and (viii) Pier and Anchor service for tourism ships)

In addition, there are 6 types of business that may freely render by a company which having Australian shareholders as part of its investors, without obtaining a business certificate i.e., Retail (Sale of Telecommunication Equipment); Wholesale (Sale of Telecommunication

[67] Please visit the DBD's website, https://www.dbd.go.th/dbdweb_en/ (accessed October 30, 2019)

[68] Ibid.

Equipment); Other categories of Service Business (i.e., 1. Telecommunication Consulting Service; 2. Leasing service of Telecommunication Station Equipment; 3. Database Access Services; and 4. Domestic Very Small Aperture Terminal VSAT). However, this will be subject to certain qualification and conditions required for such specific business activities as mentioned in the Thai – Australia Free Trade Agreement.

(iv) Being granted a business certificate for rendering specific 8 types of business under the Japan-Thailand Economic Partnership Agreement aka JTEPA Agreement. This will also be subject certain qualifications and required proportion of shareholding between Thai and Japanese investors as conditions for each type of business which includes (i-ii) Wholesale or Retail (except for distilled alcohol) of products manufactured by the company or subsidiaries located in Thailand under the same brand; automobile products manufactured by the subsidiaries in Japan under the same brand, (iii) Advertising Business, (iv) Hotel Business, (v) Restaurant Business, (vi) Management Consulting Service, (vii) Logistics, (viii) Consulting Service, except for every type of transportation service, Maintenance and Repair Service Business for Household electrical appliances that such companies conduct the wholesale businesses in Thailand and such products are manufactured by such companies or subsidiaries in Thailand under the same brand; or Household electrical appliances that the subsidiaries in Japan manufacture under the same brand.

Capital Requirement under the FBA

A foreign entity that wishes to conduct business in Thailand must have a minimum capital to be used at the commencement of the restricted business and non-restricted business. The required minimum capital for **each** restricted business is at least Three Million Baht per business. This is only a minimum which is subject to the following formula: "*25 percent of the average estimated expenditure per business per year for three years. However, this must not be less than three million baht."* Thus, it will need to calculate the amount of minimum capital to be used for each type of specific business in order to determine how much capital will be required in operating each specific business.

For non-restricted business: the required minimum capital for each business will be at least Two Million Baht.

Please note that full payment of minimum capital must be brought into the Kingdom prior to commencement of such restricted or non-restricted business.

Work Permit & Visa Extension: 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, according to its set regulations and compliance. For a BOI or IEAT promoted companies, it is required to follow and comply with such Authority's criteria and regulations set for work permit and visa extension for foreign expatriates.

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 one day, 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 single flat rate of Baht 500.

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 and 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.
    - 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 a single flat rate of Baht 5,000.

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.

Currently, the DBD has implemented its "e-Registration" for the formation of new partnerships and private companies together with the registration of any corporate changes for such juristic entities. For more information, please visit the DBD's website: http://www.dbd.go.th.

Remark: According to the laws concerning personal data protection in Thailand, enforcement was due to become fully effective for the first time on May 27, 2020; however, it has been postponed until May 31, 2022. So once, such laws come into force in the near future, the collection, use, and disclosure of any personal data must also consider and be in compliance with the related Thai laws.

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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.

Fall 21

INTERNATIONAL LAWYERS NETWORK

ÖZCAN & NATAN ATTORNEY PARTNERSHIP ESTABLISHING A BUSINESS ENTITY IN TURKEY

ILN CORPORATE GROUP

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 (local individuals, to be appointed as the signatory authority shall issue their signature declarations in the presence of the trade registry officers) 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 sirket* 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 sirket* 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 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 sirket is TL 50,000 (approx. EUR 4,850) while TL 10,000 (approx. EUR 975) for a *limited sirket*. For *anonim sirket*, if the shares are stipulated in cash, at least 25% of the related capital should be paid during the registration process and the unpaid amount should be paid within 24 months after registration. For *limited sirket,* a payment during the registration process is not required, 100% of the shares 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.

- **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 mentioned incomes utilized within Turkey will be subject to withholding tax.

- **Provisional Measures Taken by The Government Due to COVID-19**

Within the scope of governmental measures taken due to COVID-19, dividend distributions were limited until December 31, 2020. Accordingly, a company cannot distribute advance dividends until December 31, 2020. The related legislation introduces three exception groups with regard to the dividend distribution limitation. The companies fall into the scope of these exceptions are subject to the Ministry of Trade's assent. In order to benefit from these exceptions, companies must submit the related documents to the Ministry of Trade.

Three exception groups: (I) Companies that do not benefit from certain government support can make dividend distributions equal to or less than TRY 120,000. (ii) Companies can make dividend distributions without being subject to the limitation to enable its shareholders to pay their capital subscription debts to another company. (iii) Companies can make dividend distributions without being subject to the limitation if the shareholders will fulfil their due and payable credit and project finance liabilities, in cash.

Fall 21

INTERNATIONAL LAWYERS NETWORK

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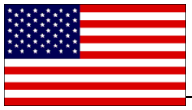
ESTABLISHING A BUSINESS ENTITY IN THE UNITED STATES

ILN CORPORATE GROUP



ESTABLISHING A BUSINESS ENTITY IN THE UNITED STATES

1. Choosing the Right Legal Structure

1.1 Introduction

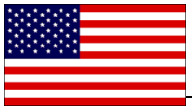
Establishing a business entity in the United States can be an important strategic step for any international company that wants to avail itself of the world's economy. There are, however, many considerations to weigh carefully in consultation with an experienced attorney. Perhaps first and foremost, 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.

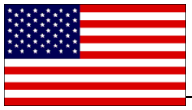
The fiduciary duties owed by directors and officers consist primarily of the duty of care and the duty of loyalty. The duty of care requires that the responsibilities of office be discharged in an informed and considered manner. The duty of loyalty requires that the relevant decision makers act on an 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 close 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 close corporation status. With the advent of the LLC (discussed later), which more readily permits management by members, close 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,

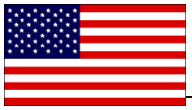


that give holders additional rights – such as priority for dividends or preference in a liquidation – and may also restrict certain other rights, such as voting. Many private corporations also, or alternatively, elect to place transfer and ownership restrictions on their shares in a separate stockholders' 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 generally 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. The U.S. also has detailed controlled foreign corporation rules under which income earned through foreign subsidiaries may be taxed. In addition, legislation enacted in 2017 has made a number of changes to the U.S. federal income tax rules applicable to U.S. domestic corporations to move the U.S. towards a modified territorial system of taxation. To accomplish this, U.S. domestic corporations are entitled to claim a deduction equal to the foreign source portion of any dividend received from certain 10% owned foreign corporations. 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 subject 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. For tax years beginning after December 31, 2017, however, the U.S. federal corporate income tax rate is reduced from a top rate of 35% to 21%, significantly reducing the impact of corporate double taxation.

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.

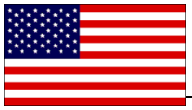
Capitalization: A partnership raises capital through equity contributions by the partners and by taking on debt. Partners may also be able to transfer their economic interest in the partnership to an outside party, such as a creditor, but with few exceptions partnership interests are not publicly traded 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 (the partnership may be liable for income tax liabilities asserted on audit, however). Instead, partners pay individual income tax on their distributive shares of partnership income (regardless of whether such income is distributed). 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. To provide for the collection of this tax, the partnership may be required to pay withholding tax on income of the partnership allocable to a foreign partner if such income is effectively connected with a U.S. trade or business. Amounts withheld can be claimed as a credit against a foreign partner's U.S. income tax liability. 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 U.S. domestic or offshore 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.

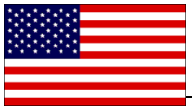
Governance: The owners of an LLC are called "members." Members may manage the LLC themselves or set up a wide variety of management frameworks using the LLC agreement, including a board of "managers" that functions much the same as a board of directors in a corporation. LLCs also may, but are not required 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 in some circumstances. A single-member LLC is treated as a disregarded entity for income tax purposes unless it elects to be taxed as a C corporation or an S-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: An LP 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

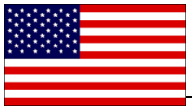
Banks: It is important to understand that none of the entities described above are appropriate for a company that will conduct commercial banking activities, such as receiving deposits or certain trust activities. In the United States, all commercial banks must be chartered by either an individual state 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 15% 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 (or was within the last five years) 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: (1) its USRPIs; (2) its interests in real property located outside the U.S.; plus (3) 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.

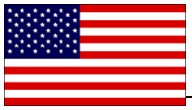
2. Forming Your Business Entity – First Steps

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 incorporator and may name 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

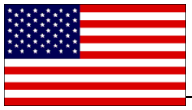
Sometimes an entity that already exists in a foreign (meaning a non-Delaware) jurisdiction may wish to become a Delaware entity. If permitted under the laws of the jurisdiction in which it currently exists, it can usually convert directly into a Delaware entity by filing of a certificate of conversion 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 countries, the U.S. imposes limits on excessive deductions for interest on debt. 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). Disallowed interest deductions on debt generally can be carried forward subject to applicable limitations. The United States also has anti-base erosion and anti-hybrid rules that may limit the benefit of interest deductions in some cases.

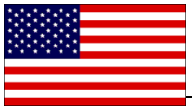
b. Operational Issues

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 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 addition, a 10% withholding tax may apply to sales of an interest in a partnership or LLC taxed as a partnership that is engaged in a U.S. trade or business by a nonresident alien individual or foreign corporation.

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 or W-8BEN-E) with the United States Internal Revenue Service claiming treaty benefits.

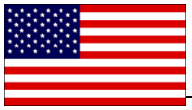
iv. Employee Tax Issues

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 a 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.

Importantly, due to the Covid-19 pandemic, several Presidential Proclamations remain in effect indefinitely, which impose restrictions on the entry of certain travelers who have been physically present in 33 countries, including Brazil, China, India, Iran, Ireland, South Africa, United Kingdom, and the European Schengen area during the 14-day period preceding their entry to the United States, including most business visa holders, in an effort to help slow the spread of Covid-19. Certain categories are exempt from the proclamations, including permanent residents and spouses/minor children of U.S. citizens. For certain business travelers, including those working in the critical infrastructure sector, as well as healthcare professionals combatting Covid-19, National Interest Exception waiver (NIE) requests can be submitted to consulate for consideration on a case-by-case basis. If granted, the NIE remains valid for twelve months. Importantly, most U.S. consulates worldwide remain unable to resume routine visa processing at this time with only limited operations or emergency appointments. As a result of the regional travel restrictions and suspension of consular services, international travel to the U.S. has been severely disrupted.

In addition, the U.S. Customs and Border Protection (CBP) continues to restrict "non-essential" travel across U.S. land borders with and ferry travel between Canada and Mexico through September 21, 2021. The restrictions are reviewed monthly and have been continuously extended since the start of the pandemic and remain in effect until rescinded. This does not, however, affect travel by air between the U.S. and Canada and/or Mexico.

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-1B1, H-2B, H-3, E-3 L, O, TN). These are available for foreign employees who fall within several specific categories. The H-1B is for specialty occupations and is a very sought-after work visa category for professionals (approximately 85,000 are available annually), which generally are professionals whose position require at least a bachelor's degree or higher, fashion models, or researchers for Department of Defense projects. The E-3 is similar to the H-1B but is limited to citizens of Australia only. The H-1B1 is also similar to the H-1B but is limited to

citizens of Chile and Singapore only. H-2B visas are for seasonal work and limited to nationals from designated countries. The H-1B, H-1B1, E-3 and H-2B visas are all subject to annual 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 in senior managerial, executive, or specialized knowledge positions. The TN is for qualified professional Canadian and Mexican citizens to work in the United States pursuant to NAFTA (effective July 1, 2020, NAFTA was replaced by the United States-Mexico-Canada Agreement (USMCA)).

- 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.
- International Entrepreneur Rule (IER). In May 2021, the Department of Homeland Security (DHS) announced the International Entrepreneur Rule (IER), which permits the DHS to use parole authority to grant a period of authorized stay, on a case-by-case basis, to foreign entrepreneurs who demonstrate that their stay in the United States would provide a significant public benefit through their business venture and that they merit a favorable exercise of discretion. Entrepreneurs granted parole will be eligible to work only for their start-up business, and for up to five years of authorization with an initial parole for up to two and half years.

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 other workers, and must provide certification from the Department of Labor that qualified U.S. workers are not available 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. However, as a result of the pandemic and limited usage of available family-based immigrant visas at consulates,

which were added to the employment-based pool of available immigrant visas, there was significant advancement in wait times across all categories, particularly benefitting Indian and Chinese nationals, which trend is forecasted to continue in 2021. 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 that 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, the type of employer, and in certain instances, his or her nationality. 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., especially in light of the Covid-19 emergency given the fluid and evolving nature of travel restrictions, proclamations and limited consular operations.

Furthermore, starting October 1, 2021, green card applicants will be required to establish that they have received a complete Covid-19 vaccination series as part of the mandatory panel physician medical exam in order to be deemed eligible for permanent residence, according to the Centers for Disease Control and Prevention (CDC). The CDC has added Covid-19 to the list of vaccinations already required of those seeking permanent residency.