

# ASEAN SOCIAL ENTERPRISE STRUCTURING GUIDE

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## JOINT FOREWORD

Social entrepreneurship has grown significantly across Southeast Asia in recent years, driven by a range of factors.

In Vietnam, Cambodia and Lao People's Democratic Republic (Lao PDR), a decline in grants from international donors has spurred non-governmental organisations (NGOs) and non-profits to develop revenue-generating activities, to make up for the aid shortfall and explore innovations in addressing social challenges. In Malaysia, the government seeks to deliver public services more efficiently and innovatively. In March 2017, they launched a Social Outcomes Fund designed to provide finance for social enterprises to deliver preventative interventions and social services that support marginalised communities. In Indonesia and the Philippines, social entrepreneurship is increasingly seen as a mechanism to generate employment for young people, raise farmer incomes and empower rural communities. In Thailand, one of the region's "early adopters," government views social entrepreneurship as an opportunity to ensure that more people can benefit from the sustained economic growth of the past two decades. Although social entrepreneurship is a more recent trend in Myanmar, the concept is rapidly gaining ground and the country has seen remarkable innovations in the past few years. Right across the Association of Southeast Asian Nations (ASEAN) region, social entrepreneurship is being recognised as an approach to reduce widening income inequality, address environmental degradation and empower women and girls.

The biggest factor is the emergence of social entrepreneurs themselves, many of them young, who have stepped up to develop financially self-sustaining solutions to address social and environmental challenges in their communities. This singular type of leader operates across the public, private and third sectors and balances the imperative of creating social impact with the need for financial sustainability. The business model that many social entrepreneurs employ to deliver impact is social enterprise. Although the idea that business can and should play a positive role in the community has deep roots in all ASEAN countries, the contemporary social enterprise business model is less well established.

As they build their enterprise from inception to launch and then to growth stage, many social entrepreneurs are receiving assistance from an increasing body of support organisations, including United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), Tilleke & Gibbins, TrustLaw, Thomson Reuters Foundation, and the British Council, which have provided access to training and funding opportunities, conducted research to identify opportunities and challenges for social enterprises, fostered academic collaboration on social enterprise and advised governments on policies that promote the growth of social enterprise and social impact investment. At the same time and to varying degrees, government in the region have started to develop support for social enterprises.

The regulatory framework for social enterprises varies between countries but with notable exceptions such as Vietnam, there is no specific legal framework in most ASEAN nations for organisations that simultaneously carry out profit-generating business activities while pursuing a social mission. In Lao

PDR establishing a business can be challenging, and none of the available legal forms are a perfect match for social enterprise. In Indonesia, there is a rigid divide between for-profit organisations and those with humanitarian objectives, posing an obstacle to nascent social enterprises. Thailand offers a number of favourable benefits including substantial tax exemptions to social enterprises, but qualifying as a social enterprise is not easy.

Even in countries with a definition of social enterprise under the law, social entrepreneurs must weigh the various options available for corporate formation and make sure they are well-informed about the legal and tax implications of each. Furthermore, legal advice is prohibitively expensive for almost all social enterprise leaders in the region; and legal expertise is limited in the areas of social enterprise and social investment.

This free guide will help social entrepreneurs better understand the complexities of setting up a social enterprise in eight ASEAN countries, the options that are available to them, and the pros and cons of different legal forms. By providing detailed information on different legal structures that social enterprises can employ this guide offers well informed advice on registering with ministries, the documentation that is required and the licenses and permits needed to carry out certain business activities. It outlines governance and regulatory obligations and provides guidance on the taxes that apply to such organisations and expenses that are tax deductible. Case studies are also included to illustrate how social enterprises have responded to specific challenges.

We believe that this resource will encourage the establishment of more social enterprises in the region, as it clearly outlines structuring options and legal frameworks in each jurisdiction. It will help support aspiring and practising social entrepreneurs, as well as the organisations that support them, to achieve their ambitions of delivering positive change in their communities.

This guide, we hope, will act as a valuable resource to be used and referred to by social enterprise leaders and social investors, by incubators and accelerators, as well as by universities and think tanks. This guide can also serve as a practical learning tool for training programmes. We will promote its use to foreign social entrepreneurs and social investors who are interested in setting up operations in Southeast Asia. It will also be useful for social entrepreneurs within the ASEAN region who are looking to scale to and incorporate in other parts of the region.

At the same time, we hope that this guide will help to spark a more detailed conversation across the ASEAN region about the approaches that individual countries are taking to support the growth of social entrepreneurship and about how the regulatory environment as a whole can be adapted to better support social entrepreneurs to achieve more impact. This in turn will support the work that our organisations do to advise governments on social enterprise policy and to promote understanding of existing legal barriers and the creation of more supportive legal and policy environments. And in doing so, it will advance our shared commitment to supporting progress on the Sustainable Development Goals and to fostering more inclusive and sustainable development in ASEAN.

This guide would not have been possible without the contributions and expertise of a number of organisations to which we hereby express our gratitude. They include:

British Council

Tilleke & Gibbins

United Nations ESCAP

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# FOREWORD

Around the world, social entrepreneurship is thriving. More and more organisations are taking a market-based approach to find sustainable solutions and have a positive social impact. Southeast Asia is no exception: investment continues to blossom, and individuals and organisations that support the space are finding new and diverse ways to help the growing number of social entrepreneurs. In the last few years, governments in the region have started to play an increasingly active role in supporting the sector's evolution.

The Thomson Reuters Foundation has always championed the emerging impact economy. A key priority for TrustLaw, the Thomson Reuters Foundation's global pro bono service, is to support innovative organisations who are addressing environmental, humanitarian and social problems across the globe. We are continuously inspired at the passion, innovation and resilience of these businesses. Our work in Southeast Asia continues to prove that social entrepreneurs are at the forefront of driving change and creating social impact. We know all too well, that the legal structure they choose for their venture can have a significant bearing on their ability to achieve social change.

As the lines between 'doing good' and running a commercial business continue to blur, new and innovative ways of structuring social ventures are now common practice in Southeast Asia. However, identifying the right structure for a social venture in Southeast Asia can feel like an impossible task. This guide is designed to help social entrepreneurs navigate their way through the different options available to them, and to act as a resource for lawyers and other advisers to social entrepreneurs lending their expertise to help.

Recognising the legal and regulatory challenges for the social enterprise model in the region, this guide covers the range of legal structures that social entrepreneurs can take advantage of, for their social ventures in eight jurisdictions in Southeast Asia. The guide identifies the advantages and disadvantages of each structure and sets out the relevant registration procedures, regulatory and governance considerations, tax treatment as well as finance and fundraising options – an understanding of all of this is so crucial to ensuring the sustainability, good governance and success of a social venture.

We are proud of this resource and hope the guide is a valuable tool to support social entrepreneurs across Southeast Asia who are shaping the future of the social impact space. We also wish to acknowledge the outstanding effort and extensive resources that our partners provided in preparing this Guide, including those who kindly agreed to be featured.



**Nicholas Glicher** – Director, TrustLaw  
Thomson Reuters Foundation

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This guide would not have been possible without the contributions and expertise of a number of organisations. British Council, the Thomson Reuters Foundation and the United Nations ESCAP wish to express their gratitude to the team at Tilleke & Gibbins for donating their time and expertise to this project. The TrustLaw team is especially grateful to the lawyers who contributed to the research and the coordination of this guide.

We express our gratitude to the following law firms who contribution to the country specific research was invaluable:

## Coordinating Law firm:



Tilleke & Gibbins

## Law firm by chapter:



Tilleke & Gibbins (Cambodia, Laos, Myanmar, Thailand, Vietnam)

Christopher & Lee Ong (Malaysia)



Oentoeng Suria & Partners in association with Ashurst (Indonesia)



Romulo Mabanta Buenaventura Sayoc & de Los Angeles (the Philippines)

## Local partners:



Cambodia: ImpactHub Phnom Penh



Indonesia: UnLtd & Socolas



Malaysia: MaGIC Social Entrepreneurship



Myanmar: MBE Myanmar Business Executives Association



The Philippines: Philippine Social Enterprise Network (Phil-SEN)



Thailand: Thai Social Enterprise Office (TSEO)



Vietnam: Central Institute for Economic Management (CIEM)



## ABOUT THE BRITISH COUNCIL

The British Council is the United Kingdom's international organisation for educational opportunities and cultural relations.

Through our [Global Social Enterprise programme](#), we promote the development of social entrepreneurship to help address entrenched social and environmental problems and deliver positive change in our communities and societies.

Our work draws on UK experience and expertise and is delivered across 29 countries with local and international partners.

Together, we provide social entrepreneurs with access to training, mentoring and funding opportunities and promote social enterprise education in schools and universities. We convene policy dialogues, organise study tours and conduct research to share knowledge and best practice in scaling social enterprise and social investment. We also deliver international development projects that promote the growth of social entrepreneurship.

It is a systemic approach designed to help foster a more sustainable, inclusive and prosperous future and build collaboration, opportunities and trust between the UK and other countries.

Twitter: [@SocEntGlobal](#)

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## ABOUT UNITED NATIONS ESCAP

The Economic and Social Commission for Asia and the Pacific (ESCAP) serves as the United Nations' regional hub promoting cooperation among countries to achieve inclusive and sustainable development. The largest regional intergovernmental platform with 53 member States and 9 associate members, ESCAP has emerged as a strong regional think-tank offering countries sound analytical products that shed insight into the evolving economic, social and environmental dynamics of the region. The Commission's strategic focus is to deliver on the 2030 Agenda for Sustainable Development, which it does by reinforcing and deepening regional cooperation and integration to advance connectivity, financial cooperation and market integration. ESCAP's research and analysis coupled with its policy advisory services, capacity building and technical assistance to governments aims to support countries' sustainable and inclusive development ambitions.





# ABOUT THE BRITISH COUNCIL'S PARTNERSHIP WITH THE UNITED NATIONS ESCAP

The British Council and the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) have a collaborative agreement to promote the growth of social enterprise and social impact investment across the Asia-Pacific region as a means of supporting progress on the Sustainable Development Goals (SDGs).

These two partners cooperate to provide research, analysis, training, policy dialogues and offer guidance to support policy makers and other stakeholders in formulating and implementing policies and strategies that foster social enterprise and create enabling environments for social impact investment.

At the Social Enterprise World Forum 2017 in Christchurch, New Zealand, these two organisations convened a policy dialogue that brought together ministers and senior government officials from 17 countries and produced the Asia-Pacific Declaration on Social Enterprise and Impact Investment which enjoins the partners as well as leading global and regional organisations (Social Enterprise World Forum (SEWF), the Global Steering Group for Impact Investment, the Global Social Entrepreneurship Network, the Asian Venture Philanthropy Network, and the Ākina Foundation) to build a community of leaders across the Asia-Pacific with the aim of sharing experience and pooling expertise around the growth of social enterprise and impact investment.

In support of this agenda, the British Council and ESCAP endeavour to increase collaboration and participation by all stakeholders in Asia and the Pacific and to design programmes and policies that are contextually relevant to the region. Their aim is to support countries to promote social innovation, inclusion, sustainable job creation, and address some of the social and environmental challenges the region faces through private sector models.

Social enterprises harness trade, investment and business activity towards social and environmental objectives and are increasingly recognized as critical drivers of innovation for sustainable development. A growing body of research indicates that social enterprises are creating jobs for disadvantaged groups, empowering women and young people, and addressing social exclusion across the Asia-Pacific region.

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# ABOUT THE THOMSON REUTERS FOUNDATION

The [Thomson Reuters Foundation](#) acts to promote socio-economic progress and the rule of law worldwide. The Foundation runs initiatives that inform, connect and ultimately empower people around the world: access to free legal assistance, media development and training, editorial coverage of the world's under-reported stories and the Trust conference.

[TrustLaw](#) is the Thomson Reuters Foundation's global pro bono legal programme. We connect high-impact NGOs and social enterprises working to create social and environmental change with the best law firms and corporate legal teams to provide them with free legal assistance. With a presence in over 175 countries, we support more than 3,500 organisations with free legal assistance. Our free legal service enables NGOs and social enterprises to streamline operations, expand into new countries and scale their impact. This helps them focus on their mission without spending valuable resources on their legal needs. TrustLaw also produces a wide range of tools to help NGOs and social enterprises address their legal needs and support their advocacy efforts.

35% of TrustLaw's members are classified as social enterprises. As well as connecting them to law firms able to provide free legal services, we work in partnership with social enterprise incubators and other intermediaries to ensure our work has the widest possible reach. TrustLaw is not only helping these organisations to secure a solid legal footing, but also supports the development of the wider social enterprise and social finance ecosystem, allowing them to be sustainable. TrustLaw is committed to providing a suite of guides, resources, interactive tools and training, all designed to make it as easy as possible for social entrepreneurs to achieve their goals.

To learn more, take a look at our Social Innovation page at [www.trust.org](http://www.trust.org).

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## ABOUT TILLEKE & GIBBINS

Tilleke & Gibbins is a leading regional law firm in Southeast Asia. With 150 lawyers and consultants in Bangkok, Hanoi, Ho Chi Minh City, Jakarta, Phnom Penh, Vientiane, and Yangon, we represent the top investors and the high-growth companies that drive economic expansion in Asia in the key areas of commercial transactions and M&A, corporate services, dispute resolution and litigation, and intellectual property. Established in 1890, we have grown into the largest independent law firm in Thailand and a leading international firm in Cambodia, Indonesia, Laos, Myanmar, and Vietnam due to our client focus, regional expertise, and international vision.

Tilleke & Gibbins' lawyers and staff are dedicated to being valuable members of the communities in which we live and do business. We proudly commit resources to targeted initiatives that support justice, education, culture, and the environment, whether through our extensive pro bono initiatives, academic scholarship programs, online library of free-to-access legal resources and publications, or our Museum of Counterfeit Goods and Southeast Asian Textile Collection (both of which are open to the public free-of-charge). In all of these endeavours, as with our legal advice and representation, we value sustainability above all else and ensure that any contribution we make has an enduring and tangible effect on those we work with.



# INTRODUCTION

## CAMBODIA

Cambodia is often seen as a very favourable environment for humanitarian efforts, having the second largest number of NGO's per capita of any country on earth. Furthermore, all of those NGOs were formed (or entered the jurisdiction) under a legal system being rebuilt following its wholesale disassembly under the Khmer Rouge. As such it is true that corporate legislation has developed in a uniquely fertile environment for humanitarian endeavours. That said, there is no specific definition of social enterprise under the law, and social entrepreneurs must therefore weigh up the various different options available for corporate formation. In addition, Cambodian law can be challenging to navigate, and any social enterprise should thus have a good understanding of the various legal requirements and allowances that go with their business operations, and corporate structure, to avoid falling foul of the law.

## INDONESIA

Social enterprise is a growing field in Indonesia, building on a pre-existing culture of community support and having increasingly caught the public's attention since the empowering political reforms that have taken place in the country since 1999. Nevertheless, support for social enterprises generally comes from the existing non-profit sector and the government is yet to take up the charge, maintaining a rigid divide between for-profit organizations and those with a humanitarian bent. The law can therefore pose an obstacle to nascent social enterprises, with no clear legal structure available in Indonesian law that meets all the needs of a social enterprise. Social entrepreneurs must therefore have a good understanding of the structures available to them so that they can take a creative approach to fitting their goals into the legal structures available for operating in Indonesia.

## LAO PEOPLE'S DEMOCRATIC REPUBLIC

In Lao PDR the legal system was entirely repealed and rewritten following the accession of the ruling party in 1975, and then heavily reformed from 1986 onwards with the adoption of a market economy. Establishing a business of any sort in Lao PDR can therefore raise some particular challenges, and none of the legal options which are available are a perfect match for the social enterprise model. However, there are legal options which can be adapted to suit these needs, both through for-profit and non-profit structures, and the benefits which social enterprise can bring are perhaps more significant in Lao PDR than in other jurisdictions in the region. Poverty alleviation and human development are key priorities of the government, but the sector experiences a lack of funding and human resources, and does not benefit from the international attention which other developing countries in the region have. This has left substantial gaps in the voluntary sector that social enterprises are very well equipped to fill.

## MALAYSIA

High levels of economic development and a large, well-educated, socially conscious middle class have fuelled a well-developed social enterprise sector in Malaysia. Enterprises receive strong support, and a number of organizations exist throughout the country, which are dedicated to supporting social entrepreneurs and their businesses, many of which receive government support and funding. However, similar to other countries in the region, there are no specific legal provisions for social enterprise in Malaysia, and those wishing to set up such a business must make sure they are well-informed about the legal structures available to them under the law.

## MYANMAR

Despite being a least developed country Myanmar has had the distinction of being ranked as the world's most charitable country every year since 2014 in the Charities Aid Foundation's annual World Giving Index. It is perhaps no surprise then that social enterprise, although a relatively new phenomenon, is proving extremely popular. Innovative approaches to commercial enterprises motivated by community development are becoming increasingly common in major cities. A reform program for modernizing Myanmar's legal system is currently underway, but for now the options available to social entrepreneurs remain limited to more traditional business structures.

## PHILIPPINES

Social enterprise is a well-established economic sector in the Philippines, and is dynamic, vibrant, and innovative. University degrees in social enterprise are available from some of the leading Philippine universities, well-established formal support networks prop up the sector and those seeking to enter it, and at the time of writing there are over 160,000 social enterprises estimated to be operating in the country. There is also a drive to provide significant support for social enterprises through formal legislation, with a bill currently being considered by the Senate which, if passed, would create a statutory Social Enterprises Development Council to promote, grow, and develop the social enterprise sector. Social enterprises therefore already benefit from a supportive and beneficial environment, and appear to have an increasingly bright future ahead.

## THAILAND

If a social enterprise is able to meet the legal criteria for a social enterprise then Thailand is an extremely friendly legal environment to operate in. Consecutive Thai governments have been enthusiastically in favour of social enterprise for over a decade, and the concept has been codified into law since 2011. Companies that meet the legal criteria are entitled to a raft of favourable benefits including, as of 2016, substantial tax exemptions. In addition, the National Reform Council is actively pursuing a number of other initiatives related to social enterprise, including education, research, and funding program, and the enthusiasm for social enterprise is likely to continue as the government transitions back to democracy over the coming years. Although qualifying as a social enterprise is not easy, for those that do so, the situation is very supportive and bound to improve.

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## VIETNAM

The concept of social enterprise was introduced into Vietnamese law in 2015, and is applicable to businesses which invest at least 51 percent of their profits in accomplishing a registered social or environmental objective. They typically operate as either single-member limited liability companies, multiple-member limited liability companies, or shareholding companies, and are entitled to be “considered for special treatment,” in a number of administrative and regulatory processes. In addition, being classified as a social enterprise in Vietnam can entitle companies to a number of funding options that would otherwise be unavailable. The social enterprise system in its current form has been well-received, and the government continues to encourage and support them.

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# DISCLAIMER

Thomson Reuters Foundation, British Council, Tilleke & Gibbins and United Nations ESCAP have created this Guide purely to inform and to assist its readers in learning more about legal vehicles used by non-profit (charitable) and/or socially driven businesses. The contents of this Guide are for information purposes and to provide an overview only.

This Guide does not provide legal information on all corporate forms available and is current as of February 15, 2018. Although we hope and believe this Guide will be helpful as background material, we cannot warrant that it is accurate or complete, particularly as circumstances change after publication.

This Guide must be considered as an overview only. It does not constitute legal advice and should not be relied on as such. This Guide is general in nature and may not apply to a particular factual or legal circumstance faced by a social or philanthropic venture. To address a specific situation, it is always recommended to seek independent legal advice.

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# CAMBODIA





# CAMBODIA

## INTRODUCTION

As a social enterprise can be for-profit or not-for-profit, there are a number of different structures which they can pursue under Cambodian law. The most popular of these are associations and NGOs, which are more numerous in Cambodia than almost anywhere else in the world, and these offer a very attractive structure for social enterprises that are not concerned with shareholder or board member profits. However, it is also worthwhile to carefully consider a number of other corporate structures: namely sole proprietorships, partnerships, limited companies, and representative offices of foreign companies, when deciding how to form such a venture.

Regardless of the company structure chosen, there are a number of provisions which apply to any organizations. Labor law requirements, for example, require all businesses to store a copy of the labor law, report staff turnover, and maintain an enterprise register and payroll book. If a business employs at least eight employees, it must also establish and register an internal code of conduct and participate in the National Social Security Fund schemes.

Any business located in Phnom Penh and engaging in any of the following sectors must register with the Ministry of Labor and Vocational Training: garment, textile and footwear manufacturing, industry, enterprises that recruit labor to work overseas, construction, hotel, banking, aviation, and maritime businesses. Depending on the number of employees, the registration fee is between KHR 80,000 (approx. USD 20) and KHR 1 million (approx. USD 250). This is in addition to any requirement to register with the municipal/district Office of Labor and Vocational Training.

Many business activities require other special licenses or permits that are issued by a range of ministries and local authorities, and these should be checked before establishment.

In respect of tax, the expenses of a social enterprise are only tax-deductible against revenues relating to business operations. For example, a social enterprise that rescues homeless people from the streets and teaches them to work in a restaurant or hotel might be able to deduct the costs of the job training from business revenue, but it probably may not deduct the costs of providing shelter or other assistance that is not related to the business operation.

These are just some examples to illustrate that there may be other legal implications of operating a business in Cambodia (and indeed any other jurisdiction) beyond the considerations of company setup and governance, and advice on those relevant to your business should be sought before doing business. This chapter is merely intended as an overview (albeit a thorough overview) of the company structures available.

## LEGAL STRUCTURE 1 – SOLE PROPRIETORSHIPS

### a. Overview

A sole proprietorship is a business that is owned by one individual. It is the simplest form of business. It has no legal status separate from its owner, so its owner is wholly responsible for financing and managing the business. The sole proprietorship is a structure often employed for small businesses.

### b. Advantages and disadvantages

Advantages:

- ✓ A sole proprietorship is subjected to minimal formalities, making it easy and inexpensive to form and operate.
- ✓ The owner of a sole proprietorship has full and direct control over all aspects of the business, and gets to keep all of the profits.

Disadvantages:

- ✗ Sole proprietorships' main sources of capital are limited to the owner's personal and borrowed capital.
- ✗ The owner of a sole proprietorship is wholly liable for all of the business's debts and other obligations, because there is no legal distinction between the business and its owner.
- ✗ A sole proprietorship ends if its owner dies. If the assets of a sole proprietorship are inherited or transferred, a new sole proprietorship is formed.

### c. Establishment process, documentation and costs

Establishing a business as a sole proprietorship requires very little paperwork. Sole proprietorships that are subjected to tax on profit must register with the Ministry of Commerce (MOC). Under current tax law, these are sole proprietorships that qualify as self-assessed regime taxpayers (SART) (see Section (e) below). Registration of the business can be performed online or physically at the Business Registration Department of the MOC. The registration fee for a sole proprietorship is just KHR 340,000 (approx. USD 85), which is lower than the registration fee for other business forms. The required documents are:

- a document proving the address of the business (e.g., utility bills, rental agreement, etc.);
- a certified copy of the owner's identity card or passport;
- a photo (4x6 inch) of the owner; and
- a declaration by the owner that he/she has not been convicted in a business, civil, or criminal case, and is not a civil servant.

After registering with the MOC, the sole proprietorship must register its business address with the city or provincial municipality where the business is located.

Sole proprietorships that are not subjected to tax on profit have to obtain a business permit from the Provincial/Municipal Department of Commerce. Under current tax law, these are sole proprietorships that do not qualify as a SART (see Section (e) below). This permit can be obtained at the One Window Service office in

the province or district where the sole proprietorship is located, with a government fee of KHR 25,000 (approx. USD 7.50). The permit is valid for one year and can be renewed. The required documents are:

- the application form;
- a copy of the owner's identity card or passport;
- a copy of patent tax certificate (if any);
- three photos (4x6 inch) of the owner; and
- a contract declaring that the business will comply with all laws and regulations of Cambodia.

In addition, all sole proprietorships must register with the General Department of Taxation (GDT) within 15 days of commencing their business activities or after registering with the Provincial/Municipal Department of Commerce or the MOC, whichever is earlier. If the sole proprietorship is a medium or large taxpayer (see Section (e) below), the registration fee at the GDT is KHR 400,000 (approx. USD 100). Otherwise, the registration fee at the GDT is KHR 20,000 (approx. USD 5). The amount of paperwork required varies among the different categories of taxpayers.

Lastly, the sole proprietorship must register with the Municipal/Provincial Department of Labor and Vocational Training before commencing business operations

#### **d. Liabilities**

The owner of a sole proprietorship has unlimited liability for all of the business's actions and debts. If the sole proprietorship cannot pay its debts or meet its obligations, the owner's personal assets may be seized to satisfy the creditors' claims.

#### **e. Tax treatment**

The tax treatment of a sole proprietor depends on whether the proprietorship falls in one of the three categories of a self-assessed regime taxpayer (SART):

- Small taxpayer: if the proprietorship's annual turnover equals or exceeds KHR 250 million (approx. USD 62,500), or its previous or expected turnover for three consecutive months equals or exceeds KHR 60 million (approx. USD 15,000), or it participates in any bidding or quotation for supply of goods or services.
- Medium taxpayer: if the proprietorship's annual turnover exceeds KHR 700 million (approx. USD 175,000).
- Large taxpayer: if the proprietorship's annual turnover exceeds KHR 2 billion (approx. USD 500,000).

If the sole proprietorship does not qualify as a SART, it does not need to pay or collect various taxes, including the following:

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## Tax on profit

Sole proprietorships that qualify as small taxpayers enjoy simpler accounting requirements and are taxed on annual profit as follows:

| Profit (KHR)              | USD (equivalent) | Tax rate (percent) |
|---------------------------|------------------|--------------------|
| 0 to 12,000,000           | 0 – 3,000        | 0                  |
| 12,000,001 – 18,000,000   | 3,001 – 4,500    | 5                  |
| 18,000,001 – 102,000,000  | 4,501 – 25,500   | 10                 |
| 102,000,001 – 150,000,000 | 25,501 – 37,500  | 15                 |
| Above 150,000,000         | Above 37,500     | 20                 |

Sole proprietorships that qualify as small taxpayers have tax advantages over most limited companies, which are subjected to a flat 20 percent tax on profits, since they pay less than 20 percent on profits under KHR 150 million (approximately USD 37,500). However, sole proprietorships that qualify as medium or large taxpayers are taxed in the same way as a limited company.

The expenses of a social enterprise are only tax-deductible against revenues relating to business operations. For example, a social enterprise that rescues homeless people from the streets and teaches them to work in a restaurant or hotel might be able to deduct the costs of the job training from their business revenue, but it probably may not deduct the costs of providing shelter or other assistance that is not related to the business operation.

Gifts and donations are generally non-deductible expenses. Charitable contributions are generally deductible if (1) they are made to registered organizations, which serve religious, charitable, scientific, literary, or educational purposes with no part of the assets or earnings used for private interest, and (2) to the extent that they do not exceed 5 percent of the enterprise's taxable profit.

## Patent tax

The annual patent tax is currently payable at the following rates, per business activity and location:

- Small taxpayer: KHR 400,000 (approx. USD 100)
- Medium taxpayer: KHR 1,200,000 (approx. USD 300)
- Large taxpayer: KHR 3 million (approx. USD 750) or KHR 5 million (approx. USD 1250), depending on revenue and other criteria of the GDT

## Value-added tax (VAT)

VAT is imposed at a rate of 10 percent on supply of most goods and services. VAT is not applicable to exported goods and services consumed abroad. Sole proprietorships that qualify as small taxpayers are allowed to claim 80 percent of input VAT, except for supply of gold, diamond, gems, and money exchange.

## Minimum tax

Minimum tax is an annual tax imposed at the rate of 1 percent on the sole proprietorship's annual turnover, inclusive of all other taxes except VAT. Minimum tax is payable instead of tax on profit if it is higher than the tax on profit.

## Withholding taxes

Sole proprietorships that qualify as medium or large taxpayers are required to withhold and transmit taxes at rates of 4-15 percent to the GDT on many payments, such as rentals, various services performed by an individual person, interests, royalties for intangible properties, and interest in minerals. Sole proprietorships that qualify as small taxpayers are only required to withhold taxes on rental payments.

### f. Ongoing governance and regulatory obligations

Subject to applicable licensing requirements, a social enterprise established as a sole proprietorship may engage in any permitted business activities alongside its charitable activity. There is no specific governance or formality required. The owner has full direct discretion over how the sole proprietorship should operate.

Any changes to the name, ownership, business objective, legal form, or address of the business must be filed with the GDT and, depending on where the business is registered, the MOC or the Provincial/Municipal Department of Commerce. Sole proprietorships that qualify as SARTs have to issue invoices for all transactions, fulfill all monthly and annual tax filing requirements, and keep accounting records and supporting documents for at least 10 years.

### g. Corporate structure

Sole proprietorships do not face statutory corporate structures or formalities.

### h. Governance

A sole proprietorship can have only one owner. The owner must be a natural person (not a corporation or other legal entity), and the owner can be any nationality. If additional owners are added to the business, the sole proprietorship must change its legal form to a partnership.

### i. Finance and fundraising

A sole proprietorship's capacity to raise capital is quite limited compared to partnerships and limited companies. Its sources of capital are limited to the assets of the owner and the capital the owner is able to borrow in his personal capacity from friends, relatives, and financial institutions. Any gifts and grants received by a sole proprietorship must be included in its taxable income for the period in which the gift or grant was received.

When a sole proprietorship borrows money, interest payments made by the proprietor are deductible to the extent they do not exceed the sum of the proprietorship's total interest income plus 50 percent of the net non-interest income.

If the initial or future financial needs of the business cannot be sustained solely by the owner, the business should probably be structured as a partnership or a limited company instead of a sole proprietorship.

### j. Resources

<https://www.businessregistration.moc.gov.kh/application-for-registration/>

<http://www.tax.gov.kh/en/taxtypes.php>

<http://www.doingbusiness.org/data/exploreeconomies/cambodia/starting-a-business/>

<https://cambodia.tax.gov.kh/>

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## LEGAL STRUCTURE 2 – PARTNERSHIPS

### a. Overview

A partnership is similar to a sole proprietorship, but has more than one owner. It is formed by an agreement between two or more partners, who pool together their knowledge, skills, capital, and other resources to conduct business with a common view toward achieving profits. Partners are prohibited by law from receiving a wage for their work with the partnership, and unless agreed otherwise, the partners share the profits equally. Although a partnership obtains distinct legal personality from the partners upon registration with the Ministry of Commerce (MOC), the partners still have unlimited liability for the debts of the partnership.

### b. Advantages and disadvantages

Advantages:

- ✓ Partners share responsibility for management, profits, and losses of the partnership.
- ✓ Partners usually bring an enhanced mix of skills and knowledge to the partnership.
- ✓ More partners bring in more capital to the partnership.

Disadvantages:

- ✗ Conflicts may arise among partners when they have different opinions on how the business should be operated.
- ✗ All partners are jointly and severally liable for all of a partnership's debts and other obligations.

### c. Establishment process, documentation and costs

Many partnerships are informal and lack a written partnership agreement. However, by law the partners are required to begin their partnership with a written partnership contract, which should stipulate, among other things, the amount and type of each partner's contribution, each partner's responsibilities, how the profits and losses are shared, the management role of each partner, decision-making and voting rights, the procedure for adding and removing partners, the transfer of a partnership interest, dispute resolution, remedies, and termination.

Partnerships must register with the MOC, and each partner is individually responsible for that task. The registration can be performed online or physically at the Business Registration Department of the MOC. The registration fee is currently KHR 1.72 million (approx. USD 430). The documents required are:

- a document proving the address of the business (e.g., utility bills, rental agreement, etc.);
  - the partnership agreement;
  - certified copies of identity cards or passports of partners and managers;
  - photos (4x6 inch) of the partners and managers; and
  - a declaration by the manager that he/she has not been convicted in a business, civil or criminal case, and is not a civil servant.
-

If a partner is a legal entity, they will also require:

- a certified copy of that partner's business registration certificate; and
- a copy of the resolution to invest in the partnership and to appoint the shareholder representative.

Within 30 days of receiving its commercial registration certificate, the partnership must deliver two original copies of the partnership agreement to the Business Registration Department. If a partner is a legal entity, they must also provide the original resolution to invest in the partnership and to appoint the shareholder representative.

After registering with the MOC, the partnership must register its business address with the city or provincial municipality where the business is located.

In addition, partnerships must register with the General Department of Taxation (GDT) within 15 days after commencing business activities or receiving their registration certificate from the MOC, whichever is earlier. If the partnership qualifies as a medium or large taxpayer (see Section (e) below), the registration fee at the GDT is KHR 400,000 (approx. USD 100). If the partnership qualifies as a small taxpayer, the registration fee at the GDT is KHR 20,000 (approx. USD 5). The amount of paperwork required varies among the different categories of taxpayers.

Lastly, partnerships must register with Municipal/Provincial Department of Labor and Vocational Training before commencing business operations.

#### **d. Liabilities**

Regardless of whether a partnership fulfills its duties to have a written partnership agreement and to register, each partner has unlimited liability for the debts and other obligations of a partnership. These liabilities can include, for example, liabilities resulting from contract claims, employee claims, and negligence claims (torts). Thus, each partner risks his/her personal property and savings if the partnership cannot fulfill its obligations. If a partnership admits a new partner, that partner is not liable for pre-existing partnership obligations. However, a new partner's contributions may be used to repay pre-existing partnership debts.

#### **e. Tax treatment**

The tax treatment of a partnership depends on whether it falls in one of the three categories of a self-assessed regime taxpayer (SART). There are three levels of SART: small, medium, and large taxpayer.

- Small taxpayer: if the partnership's annual turnover equals or exceeds KHR 250 million (approx. USD 62,500), or its previous or expected turnover for three consecutive months equals or exceeds KHR 60 million (approx. USD 15,000), or it participates in any bidding or quotation for supply of goods or services.
  - Medium taxpayer: if the partnership's annual turnover exceeds KHR 700 million (approx. USD 175,000), or one or more partners are a legal person (instead of an individual).
  - Large taxpayer: if the partnership's annual turnover exceeds KHR 2 billion (approx. USD 500,000).
-

If the partnership does not qualify as a SART, it does not need to pay or collect various taxes, including the following:

### Tax on profit

Partnerships that qualify as small taxpayers enjoy simpler accounting requirements and the profits of each partner are taxed as follow:

| Profit (KHR)              | USD (equivalent) | Tax rate (percent) |
|---------------------------|------------------|--------------------|
| 0 to 12,000,000           | 0 – 3,000        | 0                  |
| 12,000,001 – 18,000,000   | 3,001 – 4,500    | 5                  |
| 18,000,001 – 102,000,000  | 4,501 – 25,500   | 10                 |
| 102,000,001 – 150,000,000 | 25,501 – 37,500  | 15                 |
| Above 150,000,000         | Above 37,500     | 20                 |

Partnerships that qualify as small taxpayers have tax advantages over most limited companies, which are subjected to a flat 20 percent tax on profits, since partnerships pay less than 20 percent on profits under KHR 150 million (approx. USD 37,500). Partnerships that qualify as medium or large taxpayers are taxed in the same way as a limited company.

The expenses of a social enterprise are only tax-deductible against revenues relating to business operations. For example, a social enterprise that rescues homeless people from the streets and teaches them to work in a restaurant or hotel might be able to deduct the costs of the job training from business revenue generated by their business operations, but it probably may not deduct the costs of providing shelter or other assistance that is not related to the business operation.

Gifts and donations are generally non-deductible expenses. Charitable contributions are generally deductible if (1) they are made to registered organizations, which serve religious, charitable, scientific, literary, or educational purpose with no part of the assets or earnings used for private interest, and (2) to the extent that they do not exceed 5 percent of the enterprise's taxable profit.

### Patent tax

The annual patent tax, payable for each business activity and each location, currently equals:

- Small taxpayer: KHR 400,000 (approx. USD 100).
- Medium taxpayer: KHR 1,200,000 (approx. USD 300).
- Large taxpayer: KHR 3 million (approx. USD 750) or KHR 5 million (approx. USD 1250), depending on revenue and other criteria of the GDT.

### Value-added tax (VAT)

VAT is imposed at a rate of 10 percent on supply of most goods and services. VAT is not applicable to exported goods and service consumed abroad. Partnerships that qualify as small taxpayers are allowed to claim 80 percent of input VAT, except for supply of gold, diamond, gems, and money exchange.



### Minimum tax

Minimum tax is an annual tax imposed at the rate of 1 percent on the partnership's annual turnover inclusive of all taxes, except for VAT. Minimum tax is payable instead of tax on profit if it is higher than the tax on profit.

### Withholding taxes

Partnerships that qualify as medium or large taxpayers are required to withhold and transmit to the GDT taxes at rates of 4-15 percent on many payments, such as rentals, various services performed by an individual person, interests, royalties for intangible properties, and interest in minerals. Partnerships that qualify as small taxpayers are only required to withhold taxes on rental payments.

#### **f. Ongoing governance and regulatory obligations**

Each partner is responsible for complying with the filing and record-keeping requirements for a partnership. The partnership agreement and records of the partnership must contain the names, addresses, and contributions of each partner. The partnership must submit annual declarations with the MOC, accompanied by a government fee of KHR 80,000 (approx. 20 USD).

A partnership operates within the scope of its partnership agreement. Subject to applicable licensing requirements, a social enterprise established as a partnership may engage in any permitted business activities alongside its charitable activity.

Any changes to the name, ownership, business objective, legal form, and address of the business must be filed with the GDT and the MOC. Partnerships that qualify as SARTs have to issue invoices for all transactions, fulfill all their monthly and annual tax filings, and keep accounting records and supporting documents for at least 10 years.

#### **g. Corporate structure**

A partnership is formed by two or more partners. The death or withdrawal of a partner does not automatically dissolve the partnership, but if there is only one remaining partner holding all interests in the partnership, the partnership may only continue for a maximum of 120 days.

There is no specific corporate structure required for a partnership. The partners decide on the structure, the sharing of responsibilities, and the decision making procedures for the partnership. Partners are prohibited from receiving wages from the partnership in addition to their shares of the profit.

#### **h. Governance**

A partner can be a natural or legal person of any nationality. If at least 51 percent of the ownership interests in a partnership belong to Cambodian persons (natural or legal), the partnership is considered to have Cambodian nationality. Partnerships with foreign nationality are not allowed to conduct activities that are prohibited to foreigners, such as owning land.

Partners have the right to bind the partnership in its business dealings and are jointly and severally responsible for losses of the partnership. Any contrary agreement between the partners is not enforceable against third parties. Partners may allocate tasks and profits of the business through the partnership agreement. Partners may also appoint one or more managers to manage the day-to-day affairs of the partnership.

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### **i. Finance and fundraising**

A partner may contribute to a partnership in knowledge or skills, in-kind contributions, or money. A partnership's sources of capital are normally limited to the contributions of partners and capital borrowed by the partners. Any gift or grant received by the partnership must be included in the partnership's taxable income for the period in which the gift or grant was received.

When a partnership borrows money, the interest payments are deductible to the extent they do not exceed the partnership's total interest income plus 50 percent of the net non-interest income.

Another way for partnerships to raise capital is to structure the enterprise as a limited partnership. A limited partnership is a form of partnership composed of one or more general partners and one or more limited partners. The general partner manages the business and has unlimited liability for the debts and other obligations of the limited partnership, as in the case of a normal partnership. The limited partners contribute money or property to the limited partnership, do not have any management rights, and are only liable for the partnership's debts to the extent of their investments. However, limited partners may incur unlimited liability for the partnership's obligations if they perform acts that are reserved for the general partners, or if their names appear in the name of the partnership.

Unlike a sole proprietorship, a partnership can issue new ownership interests with the consent of existing partners in order to increase capital. This means that partnerships can reduce the need to borrow funds by raising capital through equity financing. Partnerships also have more ability to borrow capital than a sole proprietorship, because there are more owners with unlimited liability to meet increased financial obligations. Unlike a limited company, a partnership cannot offer debt or equity securities to the public or issue negotiable instruments. Thus, partnerships have broader access to capital than sole proprietorships, but less than limited companies.

### **j. Resources**

<https://www.businessregistration.moc.gov.kh/application-for-registration/>

<http://www.tax.gov.kh/en/taxtypes.php>

<http://www.doingbusiness.org/data/exploreeconomies/cambodia/starting-a-business/>

<https://cambodia.tax.gov.kh/>

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## LEGAL STRUCTURE 3 – LIMITED COMPANIES

### a. Overview

A limited company is a legal entity that has the capacity, rights, and privileges similar to a natural person. It enjoys a distinct legal personality from its owners. It can own property and enter into contracts, and is subject to property taxes, income, sales, and various other taxes. The shareholders of a limited company are not personally liable for the debts and other obligations of the company, except to the extent of the amount they have invested or committed to invest.

Limited companies may be organized as private limited companies and public limited companies. A private limited company may have up to 30 shareholders. If the company has just one shareholder it is registered as a single member private limited company, but it can amend its registration if new shareholders are added. A private limited company may not offer its shares or other securities to the general public, and may only offer them to a private group of shareholders, affiliates, family members, and its managers. A public limited company can issue debt and equity securities to the general public.

### b. Advantages & disadvantages

Advantages:

- ✓ The owners are liable for the company's debts and other obligations only to the extent that they have invested or committed to invest in the company.
- ✓ Private limited companies have the ability to raise funds through both debt and equity securities issued to a private group of shareholders, while public limited companies can raise funds from the public.
- ✓ Changes in management, the transfer of shares, or the death or dissolution of a shareholder do not normally terminate the company or affect its legal status.

Disadvantages:

- ✗ In comparison to sole proprietorships and partnerships, limited companies are subject to more registration formalities, plus regulations regarding their governance and corporate structure.
- ✗ Because shareholders normally appoint a management team to control the company on their behalf (instead of managing the company themselves), there is greater potential for conflicts between shareholders, or between shareholders and management.

### c. Establishment process, documentation and costs

The incorporation process for a public limited company and a private limited company is the same. Before incorporation, the founding shareholders prepare the company's articles of incorporation, which are the governing regulations of the company. It is also possible for the shareholders to enter a shareholders' agreement (or joint venture agreement) that contains further details of their relationship, which can remain confidential because the shareholders' agreement does not need to be registered with the government.

A limited company must be incorporated with the Ministry of Commerce (MOC). It must open separate capital accounts at a local bank for each class of shares that are issued. It must have minimum capital of KHR 4 million (approx. USD 1,000). The incorporation can be performed online or physically at the Business Registration Department of the MOC. The incorporation fee is currently KHR 1.72 million (approx. USD 430). The MOC can

process the application and issue a registration certificate within a few weeks or less, although delays are fairly common, and follow up visits to the MOC are often required. The following documents are required:

- Articles of incorporation
- Document proving the address of the business (normally the office rental agreement)
- Certified copies of identity cards or passports of the founding shareholders and directors
- Photos (4x6 inch) of the founding shareholders and directors
- Declarations by the directors that they have not been convicted in a business, civil or criminal case and are not civil servants.

If a founding shareholder is a legal entity, they will also require a certified copy of the company's business registration and a certified copy of the resolution to invest in the limited company and to appoint the corporate shareholder's representative.

Within 30 days of receiving the commercial registration certificate, the limited company must deliver the following documents to the Business Registration Department:

- Two original copies of the articles of incorporation
- If a founding shareholder is a legal entity, the original resolution to invest in the limited company and to appoint the corporate shareholder's representative
- An original letter from a local bank proving that the limited company has opened a capital account

After registering with the MOC, the limited company must register its business address with the city or provincial municipality where the business is located.

The limited company also must register and obtain a tax identification number at the General Department of Taxation (GDT) within 15 days of receiving its certificate of incorporation from the MOC, for a fee of KHR 400,000 (approx. USD 100).

Lastly, the limited company must register with the Municipal/Provincial Department of Labor and Vocational Training before commencing business operations.

Private limited companies are not permitted to offer debt or equity securities to the public, but public limited companies may do so if they obtain approval from the securities market for listing (such as the Cambodia Securities Exchange), plus approval from the Securities Exchange Commission of Cambodia (SECC). This requires the company to meet a host of additional requirements and incur additional costs, including larger minimum capital, public disclosures, and audited financial statements.

#### **d. Liabilities**

Shareholders enjoy limited liability for a limited company's debts and other obligations. They are liable only to the extent of their investment or the amount they committed to invest in the company, and their personal savings or other assets are not at risk. A limited company is a separate legal entity, solely responsible for its own liabilities.

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Directors of a limited company are also generally shielded from the liabilities of the company, except where obligations result from his/her tortious or criminal acts or omissions in operating the company. One example where directors can be liable is when they authorize the issuance of shares in violation of Cambodian law.

Shareholders and directors are sometimes requested to guarantee corporate obligations, in which case they will have personal liability for those obligations.

#### **e. Tax treatment**

All limited companies are self-assessed regime taxpayers (SART). There are three levels of SARTs for small, medium and large taxpayers. The small taxpayer category is only available to sole proprietorships and partnerships, so a limited company is always considered a medium or large taxpayer. A limited company currently qualifies as a large taxpayer if:

1. its annual turnover exceeds KHR 2 billion (approx. USD 500,000), or
2. it has registered as a Qualified Investment Project (QIP).

A company needs to pay or collect various taxes, including the following.

#### **Tax on profit**

Unlike sole proprietorships and partnerships which are eligible for progressive tax levels between 0-20 percent, most limited companies are subject to a 20 percent flat tax on profits.

Gifts and donations are generally non-deductible expenses. Charitable contributions are generally deductible if (1) they are made to registered organizations, which serve religious, charitable, scientific, literary, or educational purpose with no part of the assets or earnings used for private interest, and (2) to the extent that they do not exceed 5 percent of the enterprise's taxable profit.

A limited company that is approved by the Council for the Development of Cambodia as a QIP may receive various benefits and tax holidays. Most QIPs are larger projects with minimum invested capital varying from USD 100,000 to USD 8 million, depending on the field of investment. QIPs may be eligible for various exemptions from customs duties, accelerated depreciation, tax holidays, and preferred treatment with respect to hiring foreigners.

A listed public limited company may also receive various tax incentives. Currently, public limited companies listed between 2015 and 2018 pay only 50 percent of the normal tax on profits for the initial three years of their listing.

Unlike in many other countries, corporate profits that have already been taxed are not subjected to income tax when they are distributed to shareholders as dividends. However, dividends distributed to non-resident shareholders are subject to a 14 percent withholding tax.

#### **Patent tax**

The annual patent tax, payable for each business activity and each location, currently equals:

- Medium taxpayer: KHR 1,200,000 (approx. USD 300).
  - Large taxpayer: KHR 3 million (approx. USD 750) or KHR 5 million (approx. USD 1250), depending on revenue and other criteria of the GDT.
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### Value-added tax (VAT)

VAT is imposed at a rate of 10 percent on supply of most goods and services. VAT is not applicable to exported goods and services consumed abroad.

### Minimum tax

Minimum tax is an annual tax imposed at the rate of 1 percent on the company's annual turnover inclusive of all taxes, except for VAT. Minimum tax is payable instead of tax on profit if it is higher than the tax on profit.

### Withholding taxes

Companies are required to withhold and transmit to the GDT taxes at rates of 4-15 percent on many payments such as rentals, dividends paid to non-resident shareholders, various services performed by an individual person, interests, royalties for intangible properties, and interest in minerals.

### Gifts and grants

Gifts and grants received by a limited company normally must be included in the taxable income of the period in which they are received. In case of debt financing, interest payments made by the company are deductible as long as they do not exceed the company's total interest income plus 50 percent of the net non-interest income.

## f. Ongoing governance and regulatory obligations

Subject to applicable licensing requirements, a social enterprise established as a limited company may engage in any permitted business activities alongside its charitable activity. Cambodian law requires a limited company to hold regular meetings of the board of directors at least once every three months. The chairman or one-third of the directors may call a board meeting at any time.

In addition, shareholders must hold their meetings at least once per year, with at least 20 days advance notice of each meeting. The board of directors or shareholders that together hold at least 51 percent of the voting shares of the company may call for a shareholders meeting any time.

Any change of corporate information such as the company name, address, business objectives, directors, or shareholders must be filed with the GDT and the MOC. Limited companies have to issue invoices for all transactions, fulfill all monthly and annual tax filing requirements, and keep accounting records and supporting documents for at least 10 years.

If a public limited company makes public offerings, it faces additional requirements, such as filing disclosure documents with the SECC, prohibitions on insider trading, public disclosures, more frequent board meetings, additional minority shareholder rights, and requirements to conduct internal and external audits.

## g. Corporate structure

The shareholders of a limited company control the company indirectly through their elected board of directors, which manages the affairs of the company through their appointed management team. The board of directors usually dominates high-level decisions in the company, while the company's management team is responsible for day-to-day operations. A shareholder may be a director and an officer of a limited company at the same time.

A private limited company must have at least one director, and a public limited company must have at least three directors. A listed public company is subject to additional structural requirements. For example, it must

have at least five directors and an audit committee. These structural requirements can be burdensome for small social enterprises.

#### **h. Governance**

A shareholder in a limited company can be an individual or a legal entity, and can be of any nationality. A limited company is considered to be Cambodian if at least 51 percent of the voting shares of the company are held by natural or legal persons of Cambodian nationality. Limited companies that have foreign nationality may not hold title to real estate except for condominiums.

#### **i. Finance and fundraising**

Limited companies usually have better access to capital than other forms of businesses. A private limited company can offer debt and equity securities to a private group of investors. A public limited company can offer them to the public. Public offerings are costly and incur more extensive regulatory requirements for the company. In practice, the ability to issue negotiable debt instruments or make public offerings is still very limited in Cambodia.

#### **j. Resources**

<https://www.businessregistration.moc.gov.kh/application-for-registration/>

<http://www.tax.gov.kh/en/taxtypes.php>

<http://www.doingbusiness.org/data/exploreeconomies/cambodia/starting-a-business/>

<https://cambodia.tax.gov.kh/>

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## LEGAL STRUCTURE 4 – REPRESENTATIVE OFFICES AND BRANCH OFFICES OF FOREIGN COMPANIES

### a. Overview

A company incorporated by the law of a country other than Cambodia (i.e., a foreign company) may establish a Cambodian subsidiary in the form of a partnership or a limited company as discussed earlier. A foreign company may also directly conduct some business activities in Cambodia, without establishing a separate legal entity, by establishing a representative office or a branch office.

Representative offices are traditionally considered exploratory offices that are established by a foreign company that wants to learn more about a new market before investing in a full-scale subsidiary. By law, a representative office may carry out various market research and promotional activities for its parent, but it is not permitted to earn revenue by selling goods or services, or engaging in manufacturing, processing, or construction activities. Thus, a representative office is normally not a suitable option for a social enterprise that wants to generate revenue in Cambodia.

A branch office is an office established by a foreign company to conduct commercial, revenue-generating activities in Cambodia. From an operational standpoint, a branch office is similar to a subsidiary, but since a branch office has no distinct legal personality, its parent company remains fully liable for the branch's obligations.

### b. Advantages and disadvantages

Advantages:

- ✓ A representative office faces minimal regulatory requirements due to its limited scope of operation. It is employed by foreign companies that do not offer goods and services directly to customers in Cambodia. It does not pay taxes on profits because it is not permitted to generate revenue.
- ✓ A branch office may conduct revenue-generating activities like a partnership or limited company without facing some of the regulatory requirements imposed on those two types of legal structures.

Disadvantages:

- ✗ A representative office cannot perform revenue-generating activities Cambodia.
- ✗ The parent company of a branch office has unlimited liability for unfulfilled liabilities of its branch office.

### c. Establishment process, documentation and costs

Representative offices and branch offices must register with the Ministry of Commerce (MOC). The registration can be performed online or physically at the Business Registration Department of the MOC. The MOC's registration fee is currently KHR 1.72 million (approx. USD 430). The required documents include:

- a certified copy of the original business registration certificate of the parent company;
  - a document proving the address of the business (normally an office rental agreement);
  - company resolutions to establish the branch or representative office and to appoint the manager of the branch or representative office;
  - a certified copy of the identity card or passport of the manager of the representative office or branch office;
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- a photo (4x6 inch) of the manager; and
- a declaration by the manager of the representative office or branch that he/she has not been convicted in a business, civil or criminal case and is not a civil servant.

After registering with the MOC, the representative office or branch office must register its business address with the city or provincial municipality where the business is located.

They also must register and obtain a tax identification number at the General Department of Taxation (GDT) within 15 days after receiving their registration certificate from the MOC. The registration fee at the GDT currently equals KHR 400,000 (approx. USD 100).

Lastly, they must register at the Municipal/Provincial Department of Labor and Vocational Training before commencing business operations.

Many business activities also require special licenses or permits that are issued by a range of ministries and local authorities.

#### **d. Liabilities**

Representative offices and branch offices are agents of their foreign parents with no separate legal personality. The parent company can thus be held liable for their unfulfilled obligations.

#### **e. Tax treatment**

Representative offices and branch offices are considered self-assessed regime taxpayers (SART). There are three levels of SARTs (small, medium, and large), but a representative office is considered a medium taxpayer, and a branch office a large taxpayer, by default.

Because a representative office is prohibited from engaging in any revenue-generating activity, it does not need to pay tax on profit or the minimum tax, and it does not need to collect VAT from customers. However, it remains subject to other tax requirements, such as tax on salaries paid to employees, and withholding taxes on certain services, rentals, interest and royalties. The patent tax for a representative office, payable annually for each line of business activity and each location, currently equals KHR 1.2 million (approx. USD 120).

Similar to limited companies, the branch offices of a foreign company needs to pay or collect various taxes, including the following:

##### **Tax on profit**

Branch offices are normally subject to a 20 percent flat tax on profits. If the branch office remits profits back to its parent company, the remittance is subject to a 14 percent withholding tax.

Gifts and donations are generally non-deductible expenses. Charitable contributions are generally deductible if (1) they are made to registered organizations, which serve religious, charitable, scientific, literary, or educational purpose with no part of the assets or earnings used for private interest, and (2) to the extent that they do not exceed 5 percent of the enterprise's taxable profit.

##### **Patent tax**

The patent tax for a branch office, payable annually for each line of business activity and for each location, currently equals KHR 3 million (approx. USD 750) or KHR 5 million (approx. USD 1,250), depending on revenue and other criteria set by the GDT.

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### Value-added tax (VAT)

VAT is imposed at a rate of 10 percent on supply of most goods and services. VAT is not applicable to exported goods and service consumed abroad.

### Minimum tax

Minimum tax is an annual tax imposed at the rate of 1 percent on the branch office's annual turnover inclusive of all taxes, except for VAT. Minimum tax is payable instead of tax on profit if it is higher than the tax on profit.

### Withholding taxes

Branch offices are required to withhold and transmit to the GDT taxes at rates of 4-15 percent on many payments, such as rentals, profits remitted to foreign parent company, various services performed by an individual person, interests, royalties for intangible properties, and interest in minerals.

## f. Ongoing governance and regulatory obligations

Subject to applicable licensing requirements, a social enterprise established as a branch office may engage in any permitted business activities alongside its charitable activity. A representative office, however, may only perform various market research and promotional activities for its parent, and therefore is not a likely candidate for social enterprises.

Any changes of corporate information such as the name, ownership, objective, legal form, and address of the business must be filed with the GDT and the MOC. Limited companies have to issue invoices for all transactions, fulfill all its monthly and annual tax filing, and keep accounting records and supporting documents for at least 10 years.

## g. Corporate structure

The corporate structure of representative offices and branch offices are determined by their parent company. However, the law of Cambodia requires that they are managed by at least one manager.

## h. Governance

Representative offices and branch offices are considered foreign legal persons.

## i. Finance and fundraising

Representative offices may only obtain funding from their parent company as they are not allowed to engage in profit-generating activities.

Branch offices may obtain funding from their parent companies and from sales. Any gifts and grants received by a branch office must be included in its taxable income for the period in which the gift or grant was received.

## j. Resources

<https://www.businessregistration.moc.gov.kh/application-for-registration/>

<http://www.tax.gov.kh/en/taxtypes.php>

<http://www.doingbusiness.org/data/exploreeconomies/cambodia/starting-a-business/>

<https://cambodia.tax.gov.kh/>

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## LEGAL STRUCTURE 5 – DOMESTIC ASSOCIATIONS, FOREIGN ASSOCIATIONS, AND DOMESTIC AND FOREIGN NGOS

### NGOs

#### a. Overview

Cambodia has one of the highest numbers of NGOs per capita in the world at approximately one NGO per 3000 people (as of November 2016), a statistic that does not take into account the number of unregistered NGOs.

Cambodia did not have specific laws to govern the establishment of NGOs until 2015. Before that time NGOs were encouraged to register, but many NGOs chose to remain unregistered since there were no legal sanctions against unregistered organizations. In 2015, Cambodia passed the Law on Associations and Non-Governmental Organizations (LANGO) to govern and restrict the activities of NGOs. Under the LANGO, NGOs may take one of the following four organizational forms:

- **A domestic association** is defined as a membership organization established under Cambodian law by natural persons or legal entities, with the aim of representing and protecting the interests of the association's members and without generating or sharing profits.
- **A foreign association** is an entity established in another country with the aim of conducting activities to serve the public interest without generating profits.
- **A domestic NGO** is defined as a non-membership organization, including foundations, established under Cambodian law by natural persons or legal entities, with the aim of providing funds or services in one or several sectors for the public interest and without generating or sharing profits.
- **A foreign NGO** is an entity established in another country with the aim of conducting activities to serve the public interest without generating profits.

The fundamental difference between an association and an NGO is that the former is organized to serve its members while the latter serves the general public interest. Going forward in this section of the Guide, we will refer to associations and NGOs simply as "NGOs," unless stated otherwise.

NGOs cannot share dividends among their founding members, and all of their revenues from donors or income-generating activities must be retained or invested in their social activities.

NGOs are entitled to certain tax exemptions, subject to permission granted by the government, especially the Ministry of Economy and Finance (MEF).

Domestic NGOs must register with the Ministry of Interior (MOI). Foreign NGOs must register with the Ministry of Foreign Affairs and International Cooperation (MFAIC) by establishing a memorandum of understanding (MOU) with the MFAIC.

The LANGO also requires these organizations to report their activities and finances annually to the government. Failure to comply with certain provisions of the LANGO may result in fines or deregistration, and deregistered NGOs are banned from conducting any activities in Cambodia.

The law is unclear and untested, but unless properly structured it is possible that NGOs based abroad can be held liable for the obligations of their offices registered in Cambodia, including contract obligations, tort liabilities, and taxes.

## b. Advantages & disadvantages of an NGO

Advantages:

- ✓ NGOs may be eligible for tax exemptions.
- ✓ NGOs are required to report activities and finances annually, thereby contributing to increased accountability and transparency.
- ✓ All resources and assets, whether from donors or income-generating activities, must be retained within the organization or reinvested in social activities, and cannot be transferred as dividends.

Disadvantages:

- ✗ Dividends and other fruits of success may not be shared with founders or board members.
- ✗ Registration can be challenging.
- ✗ Both the NGO and its management face onerous reporting requirements, and the obligation to report assets and liabilities.
- ✗ Under certain conditions, there is the possibility of suspension by local authorities.

## c. Establishment process, documentation & costs

### Domestic NGOs

**Establishment process:** A domestic NGO that wishes to conduct any activities in Cambodia must be registered with the MOI. By law, the MOI is required to examine the registration application and issue a decision on registration within 45 working days after receiving the application. The LANGO provides that the MOI may reject an application to register a domestic NGO if the NGO's purpose and goals would endanger the security, stability, and public order, or jeopardize national security, national unity, culture, traditions, and customs of Cambodian national society.

When reviewing an application, if the MOI concludes that the applicant has not met all criteria for registration, the MOI must inform the applicant of the deficiencies in writing within 45 working days. After receiving additional information and materials from the applicant, the MOI is supposed to issue a decision on the application within 15 more working days. The law is unclear on whether this process and time frame will repeat itself if the applicant's second submission remains deficient.

If the MOI ultimately decides to reject an applicant's registration, the applicant has the right to appeal that decision to the courts. If the MOI fails to comply with the above timeframe, the domestic NGO is deemed registered, and the MOI must prepare documents legalizing the registration. However, the law does not specify a deadline for the MOI to do this, and it is unclear whether domestic NGOs can operate legally while waiting for the MOI to do so.

**Reporting obligations:** Once successfully registered, domestic NGOs become legal entities, meaning that they have certain rights and obligations provided by law, including the right to enter into contracts under their own names, to sue or be sued in the courts, and to be liable for both civil and criminal punishments. Domestic NGOs must inform the MOI and the Ministry of Economy and Finance (MEF) in writing about all of their Cambodian bank accounts within 30 days from the date of registration. They also must inform the MOI any time they amend their statute, move their office, replace their president or executive director, or change

their bank account information. Those notices must be submitted to the MOI in writing within 15 days of the change, and must include copies of the amended documents.

Please see Section (d) below on liability for a discussion of the consequences when a domestic NGO fails to comply with these reporting obligations.

**Documentation:** Applications to establish a domestic NGO must be submitted to the MOI, and must include the following documents:

- Completed application form
- Letter issued by the commune or *sangkat* chief stating the address of the central office of the NGO
- CVs of each founding member, along with recent photographs
- The statute of the NGO, signed by its president

The statute of a domestic NGO must include the following:

- The organization's purposes and goals
- The organization's name (written in full and abbreviated), which may not be confusingly similar to the name or abbreviation of any registered domestic NGO (a name search should be conducted with the local authorities)
- The organization's logo, which may not be confusingly similar to the logo of any national or state institution, any registered domestic NGO, or the Red Cross or Red Crescent or international institutions
- Rules for selecting, transferring, and removing the president and executive director
- Rules for changing the organization's name and logo, and for amending its statute
- Sources of funding and assets
- Rules for managing assets
- Rules for dissolving and disposing of properties upon dissolution of the organization

**Costs:** The current official government fee for registering a domestic NGO is KHR 300,000 (approx. USD 75). If a domestic NGO wishes to open a branch, change its organizational structure, or amend its statute, the MOI charges an official fee of KHR 200,000 (approx. USD 50).

## Foreign NGOs

**Establishment process:** Any NGO which is established and registered abroad that wishes to conduct activities in Cambodia must register as a foreign NGO with the Ministry of Foreign Affairs and International Cooperation (MFAIC) by signing an MOU with the MFAIC. Before submitting an application to do so, the foreign NGO must reach an arrangement with the ministries relevant to that NGO's social objectives, to serve as its project partners. For example, if an NGO's main purpose is to help impoverished women, the NGO must obtain a letter of support from the Ministry of Women's Affairs, before applying for an MOU with the MFAIC. The NGO might also need to enter an MOU with that ministry after obtaining registration with the MFAIC.

**Short-term projects:** If a foreign NGO wishes to conduct a short-term project, it does not need to register with the MFIAC. Instead it can implement the project through a local partner already registered in Cambodia, or by obtaining special approval from the MFAIC.

The MFAIC has 45 working days to examine the contents of an application and decide whether or not to sign an MOU with a foreign NGO. However, unlike in a domestic NGO application, the LANGO does not state what happens if the MFAIC fails to meet the 45-day deadline. Moreover, the LANGO does not require the MFAIC to provide its reasons for refusing to register a foreign NGO, or any right to appeal the MFAIC's decision with the courts.

An MOU with the MFAIC has a maximum term of three years, and it terminates on its expiration date without any formalities, unless the foreign NGO submits a request to extend the MOU at least 90 days prior to the expiration date. The maximum extension period is three years.

**Reporting obligations:** Within 30 days of successful registration, foreign NGOs must inform the MFAIC and the MEF in writing about all of their Cambodian bank accounts. They must also inform the MFAIC any time they move their representative office, replace their country representative, or make any changes to their bank account. Notices must be submitted to the MFAIC and the MEF in writing within 15 days of the change, and must include copies of the amended documents.

Please see Section (d) below on liability for a discussion of the consequences when a foreign NGO fails to comply with its reporting obligations.

**Documentation:** Applications to register a foreign NGO must be submitted to the MFAIC, and must include the following:

- A written request letter from the president of the foreign NGO to appoint its representative (along with the representative's CV), and to open a representative office in Cambodia
- A letter from the commune or *sangkat* chief stating the address of the applicant's representative office in Cambodia
- A foreign registration document authorizing the foreign NGO to operate
- A letter of support for the foreign NGO's Cambodian projects, issued by the NGO's project partners (public authorities) in Cambodia
- A letter from the applicant's foreign headquarters, certifying the budget for implementing the applicant's projects for at least its first six months
- The applicant's letter to the MFAIC and the MEF promising to provide all local bank account information.

Some of these documentary requirements can be problematic for a foreign NGO because it must recruit a representative and rent an office in Cambodia without knowing for certain whether its registration will be approved.

**Costs:** The MFAIC's current official fee to register a foreign NGO is KHR 1.2 million (approx. USD 300), and to extend that registration is KHR 800,000 (approx. USD 200).

Foreign NGOs can request an approval letter from the MFAIC to apply for a car license plate for KHR 1 million (approx. USD 250), and a motor license plate for KHR 600,000 (approx. USD 150). Foreign NGOs wishing to amend their names and stamp must pay the MFAIC an official fee of KHR 600,000 (approx. USD 150). By law, it does not take longer than 15 days to process the requests above, although delays are common.

## d. Liabilities

### Domestic NGOs

The LANGO provides that domestic NGOs become legal entities upon registration with the MOI, and thus may sue and be sued. Founders and management of a domestic NGO are therefore assumed not to be liable for the NGO's obligations unless they have committed fraud, self-dealing or similar offenses. It is also recommended that the statute of a domestic NGO contain provisions expressly limiting the liability of its founders and its management.

### Foreign NGOs

The LANGO does not expressly state that foreign NGOs are legal entities, and it does not expressly grant limited liability to a foreign NGO's parent entity for the debts of the foreign NGO registered in Cambodia. Moreover, the LANGO always refers to the office of a foreign NGO as a representative office. To our knowledge this issue has not been resolved by the Cambodian courts, and there is at least some chance that a parent NGO can be ruled to be liable for the debts of its Cambodian counterpart, the same way that foreign for-profit companies can be liable for the debts of their Cambodian representative offices and branches under the Law on Commercial Enterprises.

### Directors

Under articles 17 and 18 of the Law on Anti-Corruption, leaders of civil society, including the leaders of domestic and foreign NGOs, must declare their assets and liabilities to the Anti-Corruption Unit, in writing or electronically, upon taking and leaving office, as well as periodically every two years, regardless of whether the assets and liabilities are inside or outside Cambodia.

Leaders of civil society who fail to declare their assets and liabilities in accordance with the Law on Anti-Corruption may be sentenced to imprisonment of one month to one year and fined from KHR 100,000 (approx. USD 25) to KHR 2 million (approx. USD 500), and be forced to declare their assets to the Anti-Corruption Unit. If the order to declare assets is resisted, other sanctions may be doubled. However, before applying any punishment, the Chairman of the Anti-Corruption Unit must instruct the leaders of the domestic and foreign NGOs in writing to declare their assets and liabilities.

### Penalties

**Domestic NGOs:** Domestic NGOs failing to comply with reporting obligations discussed above in Section (c) and the regulatory obligations in Section (f) will first be notified in writing by the MOI to comply within 30 working days. If they fail to comply within that period, the MOI may suspend their activities for up to 90 days. For repeated non-compliance, the MOI may remove the domestic NGOs from its register.

A domestic NGO that fails to comply with its statute may be notified by the MOI in writing to remedy the situation within 30 days. While pending remedial action, the domestic NGO might also be suspended. If the domestic NGO fails to comply with the MOI's notice, the MOI may remove the domestic NGO from its register.

The MOI may also deregister domestic NGOs whose activities endanger the security, stability, and public order, or jeopardize the national security, culture, traditions, and customs of Cambodian national society. These grounds for deregistration are broad and ambiguous.

If the MOI decides to suspend or deregister a domestic NGO, or impose a fine, the domestic NGO is entitled to file an appeal with the courts within 30 working days from the date of receiving the MOI notification.

Unregistered, deregistered, or suspended domestic NGOs that continue conducting activities in Cambodia face various sanctions, including possible fines of KHR 5 million (approx. USD 1,250) to KHR 10 million (approx. USD 2,500). As a last resort, authorities may file complaints to the court against the unregistered, deregistered, or suspended domestic NGOs, without prejudice to other criminal actions. The law is not entirely clear, but it is possible that these sanctions also apply to members of management of an unregistered, deregistered, or suspended domestic NGO, in part because that NGO will no longer be recognized as a legal entity.

Any domestic NGO that commits a crime (e.g., money laundering, terrorist financing or terrorist crimes, etc.) is subject to prosecution and punishment in accordance with Cambodia's criminal law.

**Foreign NGOs:** A foreign NGO that fails to comply with the reporting obligations in Section (c) above, or the regulatory obligations in Section (f), will be notified in writing by the MFAIC to comply within 30 days. If the foreign NGO fails to comply within that period, the MFAIC may issue another written warning giving the foreign NGO another 30 days to comply. Failure to do so may result in MOU termination and deregistration of the foreign NGO.

The MFAIC may also terminate an MOU with any foreign NGO that breaches its terms. In addition, the LANGO authorizes the MFAIC to terminate a foreign NGO's MOU if it conducts any activities that harm security, stability, and public order, or endanger the national security, national unity, culture, good traditions and customs of Cambodian national society. These grounds for termination are broad and ambiguous.

Unregistered or deregistered foreign NGOs that conduct activities in Cambodia will be ordered to stop their activities by the authorities, and their foreign employees may be deported and/or subject to other sanctions. Additionally, any foreign NGO that commits a crime (e.g., money laundering, terrorist financing or terrorist crimes, etc.) is subject to punishment in accordance with Cambodia's criminal law.

#### **e. Tax treatment**

NGOs are taxable entities and are subject to Cambodia's tax regime. However, they are eligible for tax incentives and tax exemptions under Cambodian law. They must register with the Tax Administration, either online or in person, within 15 days after registration with the MOI or the MFIAC. After registration the NGO will receive a tax certificate with a tax ID number (TIN) that can be used with any tax related documents.

#### **Income tax**

According to Article 9 of the Law on Taxation, the income of an entity is tax exempt if the entity is "organized and operated exclusively for religious, charitable, scientific, literary or education purposes, and no part of the assets or earnings of which is used for any private interests," or the entity is "any labor organization or any chamber of commerce, industry, or agriculture, in the case where the income of these organizations is not used for the private benefit of any shareholder or physical person."

This income tax exemption does not apply to any profits of property or business income that are not substantially related to the purpose or function which constitutes the basis for tax exemption of a non-profit organization.

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An organization that meets the requirements above may apply to the MEF for tax exemption by providing the following documentation:

- Goals and objectives of the organization
- Names and addresses of resident persons (if any) who sit on the board of directors of the organization
- Name and address of the director(s) responsible for the operation of the organization in Cambodia (for organizations connected to an organization outside of Cambodia)
- Sources and uses of all funds for the operation of the organization in Cambodia
- Assets held in Cambodia by the organization or the parent organization
- Local bank account information of the organization

Changes to the information above must be reported to the MEF within 15 days of the change.

The MEF is authorized to grant exemption on a case-by-case basis, and has sole discretion in the matter. If tax exempt status is approved by the MEF, it will remain in force as long as the NGO continues to meet the conditions in its application letter and the MEF approval.

### Value-added tax (VAT)

According to article 57 of the Law on Taxation, the sale of goods and services by “non-profit activities in the public interest that have been recognized by the [MEF]” are not subject to VAT. In order to qualify for this exemption, a foreign NGO must receive permission from the MEF. NGOs that have not received permission still need to collect VAT from their customers and turn it over to the General Department of Taxation, just like any other type of company.

In addition, foreign NGOs may request permission from the MEF to receive refunds on the VAT paid when purchasing supplies. It is normally best to include this specific provision in the MOU that is negotiated and signed with the MFAIC.

### Tax and excise exemption for importing materials, machinery, vehicles and fossil fuels

NGOs wishing to import materials, machinery, vehicles, and fossil fuels to implement their projects and operations may be exempt from paying import tax by submitting the following documents in advance to the Council for the Development of Cambodia (CDC):

- Official letter from the relevant ministries permitting the NGO to operate in Cambodia; and
- The NGO’s agreement on project implementation and/or MOU with the relevant ministries.

In addition to the documents above, the NGO must submit the following documents to the CDC for each specific import:

- Request letter from the head or authorized representative of the project implementing agency
  - Project document and/or other documents pertaining to the project for which the respective materials, machinery, vehicles, and fossil fuels are required
  - Work plan and annual budget showing sources of funds for project implementation, or a master list of required machinery, materials, vehicles, and fossil fuels to be imported with tax and excise borne by the Royal Government of Cambodia
-

- Annual progress report on project implementation from the most recent year
- List of vehicles and machinery already permitted for import and their current status/condition
- Import-related documents including the invoice, packing list, and bill of lading. For occasional humanitarian aid, a certificate of donation is also required.

Currently the CDC's official fee to process an application for an import tax exemption is KHR 1.6 million (approx. USD 400), and the approval is valid for 12 months.

When importing vehicles, NGOs must request a waiver of import taxes from the CDC before making the purchase, attaching a pro-forma invoice detailing the vehicle specifications. Generally, luxurious sedans or vehicles valued at more than USD 30,000 are not allowed, but an exemption can be requested by providing appropriate reasons to the MEF.

Materials, machinery, vehicles, and fossil fuels that are imported under a tax exemption generally may not be sold, or transferred for use at other places or by other agencies, and may not be disposed of without permission by the Customs Department.

#### **f. Ongoing governance and regulatory obligations**

All registered NGOs are entitled to enter into contracts with third parties to implement their activities, and to recruit staff or workers. The Ministry of Economy and Finance or the National Audit Authority may check and audit the financials of any NGOs.

#### **Domestic NGOs**

By law, domestic NGOs (except domestic associations) are required to "maintain their neutrality towards political parties in Cambodia." Domestic NGOs (except domestic associations) also need to submit project activity reports and annual financial reports to the MOI and the MEF by the end of February of each year.

When receiving funds from donors, if a domestic NGO distributes project activity reports and/or annual financial reports to the donors, and/or has any project document and/or financial agreement with the donors, the domestic NGO must submit copies of those documents to the MOI and the MEF within the regulatory deadline. These reports must also be maintained in the office of the domestic NGO for at least five years.

See Section (d) above for a discussion of the consequences of failing to comply.

If a domestic NGO wishes to suspend its activities, it must notify the MOI in writing, as well as submit project activity reports and financial reports to the MOI and the MEF. If the domestic NGO wishes to dissolve its entity, it must clear its third party obligations before disposing of its resources or assets. If the domestic NGO is dissolved by the courts or by MOI deregistration, the clearance of third party obligations and the disposal of resources and assets must comply with the decisions of the authorities.

#### **Foreign NGOs**

If a foreign NGO sends any project activity reports and/or annual financial reports to its donors, and/or has any financial agreement or project documents with its donors, copies must be sent to the MFAIC and the MEF within the regulatory deadline.

In the past, some foreign NGOs misunderstood that their organization and foreign employees in Cambodia were automatically eligible for certain immunities and privileges under the 1961 Vienna Convention on

Diplomatic Protection, such as immunity from civil, administration, and criminal jurisdiction, immunity from obligation to be a witness, immunity from search or attachment of property, etc. However, the LANGO clarifies that foreign NGOs, their foreign and Cambodian staff, and the family members of their staff do not enjoy those immunities and privileges, unless there is a special agreement between the foreign NGO and the Cambodian government. Moreover, foreign NGOs have an obligation to be neutral towards any political parties in Cambodia.

Please see Section (d) above on liabilities for a discussion of the consequences when a foreign NGO fails to comply with these neutrality and reporting obligations.

If a foreign NGO wishes to suspend its activities, it must notify the MFAIC in writing in advance, and it must submit project activity reports and financial reports to the MFAIC and the MEF. If the foreign NGO wishes to terminate its MOU with the MFAIC, it must clear its third party obligations before disposing of its resources or assets, in compliance with the funding agreements with its donors. According to the LANGO, if the MOU is terminated by the MFAIC, the disposal of the foreign NGO's assets must comply with the decisions of the headquarters of that foreign NGO.

## **g. Corporate structure**

Under the LANGO, there are four structures available for NGOs:

- A domestic association is defined as “a membership organization established under the laws of Cambodia by natural persons or legal entities aiming at representing and protecting the interests of their members without generating or sharing profits.”
- A foreign association is an entity established in another country with the aim of conducting activities to serve the public interest without generating profits.
- A domestic NGO is defined as “a non-membership organization, including foundations, established under the laws of Cambodia by natural persons and/or legal entities aiming at providing funds and services in one or several sectors for the public interest without generating or sharing profits.”
- A foreign association or foreign NGO refers to a legal organization established outside the country aiming at conducting activities to serve the public interest without generating profits in Cambodia.

## **h. Governance**

### **Domestic NGOs**

To establish a domestic association, there must be at least three founding members who are at least 18 years old. They do not have to be Cambodian citizens.

Domestic NGOs (except associations) must be founded by at least three founding members who are at least 18 years old and must be natural persons of Cambodian nationality.

The LANGO provides that the MOI can stipulate conditions, formalities and procedures for establishing and registering a domestic NGO by a foreign legal entity or a foreign person, and for establishing and registering a domestic association by minors, but it has not yet done so.

### **Foreign NGOs**

There are no regulations addressing the composition of the management or restricting foreigners from serving as managers of foreign NGOs.

The nationality of representatives of foreign NGOs is not restricted. For example, the Chab Dai organization, registered in Cambodia as a foreign NGO, has non-Cambodian nationals serving on both the board of directors in the USA and the representative committee in Cambodia. However, the Cambodian government generally encourages NGOs to minimize expatriate staff so as to maximize the transfer of skills and expertise to Cambodian staff.

## **i. Finance & fundraising**

### **Domestic NGOs**

By law, the resources and assets of a domestic association may consist of:

- the domestic association's own resources and assets;
- donations or subscription fees of members and other third parties (natural or legal persons); and
- other income generated from lawful sources.

The resources and assets of a domestic NGO (except domestic associations) may consist of:

- the organization's own resources and assets;
- donations from natural persons or legal entities; and
- other income generated from lawful sources.

The LANGO does not prohibit domestic NGOs from conducting income-generating activities such as selling products or services, as long as these activities are lawful. As a practical matter, there are many NGOs in Cambodia that sell products and services, especially in a start-up phase to achieve their charitable goal, such as The World Toilet Association's SaniShop model, which engages and empowers rural households by seeding low-cost sanitation-ware businesses in Kampong Chhnang.

### **Foreign NGOs**

By law, the resources and assets of a foreign NGO must be obtained from lawful sources. The law does not clarify this provision, and it is assumed that foreign NGOs can conduct any lawful activities to generate income, and receive funds from any sources

It is possible for the MOUs between foreign NGOs and the MFAIC to prohibit certain fundraising activities. For example, Article 13 of the MOU between the Royal Government of Cambodia and Paz Y Desarrollo, a Spanish NGO in Cambodia, prohibits the NGO from engaging in any profit-making activities.

## **j. Case Study: Cambodian Children's Funds**

Cambodian Children's Funds (CCF), founded in 2004 by Scott Neeson, aims to transform kids in the most impoverished communities of Cambodia into tomorrow's leaders. To this end, CCF has been providing free education, healthcare services, and family support to poor children in Cambodia's most improvised communities, centered around the former slums at Steung Meanchey. CCF also has other charitable programs, such as leadership, community outreach, childcare and vocational training for children and their families.

CCF is registered in Cambodia as a foreign NGO, and has been granted a tax exemption on its profits by the Tax Administration.



# INDONESIA





# INDONESIA

## INTRODUCTION

During the past decade, the term “social enterprise” has gained a growing popularity in public in Indonesia. This is evidenced by numerous events and programmes conducted by different organizations and institutions to promote social enterprises through different channels of publicity. These activities have contributed to the growing awareness among public audience about social enterprises.

Many institutions, corporates, universities and media utilize social enterprise to describe a distinctive model of doing business that is inherently different from conventional businesses. However, it does not mean that the public generally agree and understand what social enterprise means.

### *A Need for a Legal Guide for Social Enterprises*

Categorically speaking, social enterprises are businesses. However, they have attributes that are distinctively different from conventional businesses, as described in this guide. Below are a few reasons why there is a need for a legal guide specifically written for social enterprises in Indonesia.

The purpose of a social enterprise is to solve a particular social or environmental issue by using business or market mechanisms to do so. There is no single legal status available in Indonesia that can provide a perfect model for a social enterprise. In Indonesia, legal entities must declare whether their purposes are social or commercial in nature. Social enterprises need to know the options that are available to them, along with their consequences, and only then can they decide whether they should use for-profit or non-profit structure.

Social enterprises may need funding from donation or grants, or from investment (i.e. debt or equity). There are no available legal entities in Indonesia that allow for donation, income from commercial activities, and equity or debt investments to be received by a single legal entity.

While allowing for private ownership, social enterprises tend to prefer open and joint decision making, combined with efficient and swift execution on daily operations. It may be difficult for common legal entities to accommodate this kind of combination. For example, cooperatives are designed to allow open and transparent decision making and governance, but they do not allow for private ownership. Meanwhile, limited liability companies allow for private ownership, but they are not designed for joint decision making. Lastly, foundations are designed without allowing for individual ownerships and use a top-down approach in its governance.

### **Legal framework for social enterprises**

The legal system in Indonesia does not currently recognize a SE as a legal entity. Nonetheless, there is room for an entity to conduct activities in the spirit of SE. This can be done by establishing a business entity, whether in the form of a legal entity or a non-legal entity.

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Generally, before deciding the form of entity that will be used as the vehicle for a SE, entrepreneurs must first identify the business sector that the SE will be engaged in. There are certain types of business activities in Indonesia that are restricted only to specific business entities. Therefore, identifying the proposed business sector will assist the entrepreneurs in choosing the most suitable type of entity to pursue activities as an SE.

Further, the entrepreneurs need to consider the scope of the liabilities that they want to assume out of the business activities, i.e., whether they only want to assume limited liability based on their respective contributions in the entity or if they are willing to assume all liabilities that may be borne by the SE. In the latter case, the entrepreneurs may be required to utilise their own personal assets in the event that the SE does not have sufficient funds to pay for the obligations incurred as a result of the SE activities. This full liability concept applies for an SE that is established as non-legal entity, such as a sole proprietorship, partnership, firm or limited partnership (“**CV**”).

Meanwhile, under the limited liability concept, the entrepreneurs’ liability is limited to the amount of their respective capital investment/contribution in the SE. This concept applies for SE that is established as a legal entity, such as a foundation, association, cooperative or limited liability company (“**PT**”). Out of all of the abovementioned entities, only foundations and associations are specifically arranged under Indonesian law to achieve social and non-commercial purposes. foundations and associations are not permitted to undertake any business activities, but may participate in a business by way of capital injection in a PT. foundations and associations must use their income primarily to finance social activities.

In comparison, entities that are established primarily to obtain profit, such as PTs, are likely to use their profit for the continuity of their business operation, before using it for any other purposes, such as for dividend distribution or any other specific purpose. The utilisation for any specific purpose will depend on the discretion of the entity’s internal organ. Therefore, commitment of the founders/partners/members/shareholders is required in order to achieve social purposes. This could be done by describing the relevant social commitment in the PT’s Articles of association (“**AOA**”).

Since foundations and associations are established specifically for social purposes, it may be easier for such entities to obtain grants/donations from third parties, compared to business entities. Further, Indonesian law only allows mass organizations, such as foundations or association, to conduct fundraising.

With respect to investment, non-legal business entities and cooperatives are only allowed to obtain capital investments/contributions from Indonesian investors, while a PT may obtain capital investment from both Indonesian and foreign investors. However, there are no regulations that prohibit legal and non-legal entities in obtaining offshore financial support.

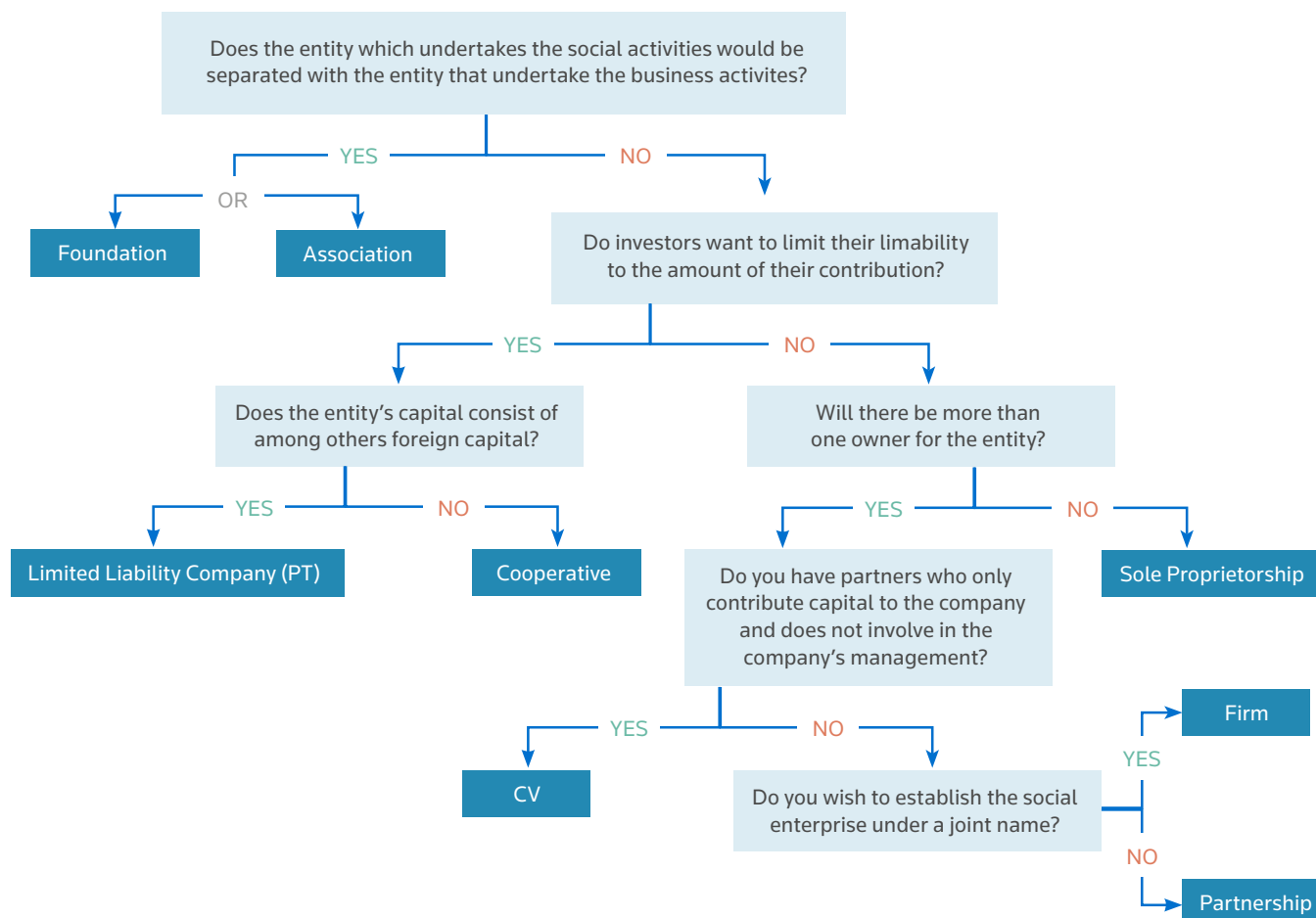
Meanwhile, with respect to the decision-making process, only a sole proprietorship can apply the “one man, one vote” principle since has a single founder with absolute authority. Any other entities must involve all of its founders/partners/members/shareholders in making a decision, either by way of consensus or voting pursuant to the provisions of their respective AOAs.

With regard to ownership of assets, legal entities can hold a title over any assets. On the other hand, assets of non-legal entities will be registered under the name of any of its founders/partners.

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## DECISION TREE

Below is a decision tree to assist social entrepreneurs in deciding which type of entity is suitable for their SE activities.



## POSSIBLE ENTITY STRUCTURES FOR SOCIAL ENTERPRISE IN INDONESIA

There are several structures that could be utilised by an SE in Indonesia, either in the form of a non-legal entity or a legal entity.

The following non-legal entities are available in Indonesia:

- i. Sole proprietorship
- ii. Partnership
- iii. Firm
- iv. CV



The following legal entities are available in Indonesia:

- v. Non-profit oriented:
  - A. Foundation
  - B. Association
- iii. Profit oriented:
  - A. Cooperative
  - B. PT

In general, the difference between a non-legal entity and a legal entity lies in the ability to assume legal liabilities. Non-legal entities cannot be subject to legal rights and obligations and it will be the partners in each entity that will be subject to all legal rights and obligations related to activities carried out in the name of the entity. On the other hand, a legal entity can be subject to legal rights and obligations related to activities carried out in its name.

The entity structure can have a significant impact on the SE itself, since it bears dual mission of profit and social value. Each entity has certain advantages and disadvantages in this respect.

Below is a table comparing the characteristic of legal and non-legal entities.

| Legal Entities                                                                                                                                              | Non-Legal Entities                                                                                                                                               |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Legal entities may be subject to the legal rights and obligations related to the activities carried out in the name of the entity.                          | The partners/founders will be subject to all legal rights and obligations related to the activities carried out in the name of the entity.                       |
| Separation of the founder's assets and the entity's assets.                                                                                                 | There is no separation of the founder's assets and the entity's assets.                                                                                          |
| Most legal entities (except for PTs) may acquire grants and donations from government authorities.                                                          | Non-legal entities cannot acquire grants or donations from government entities.                                                                                  |
| The sustainability of the legal entity is not contingent on the founders. For instance, a legal entity can continue after the founders' death or departure. | The sustainability of the entity is contingent on the founders. For instance, if one founder exits the agreement or passes away, the entity will cease to exist. |
| Legal entities can enter into agreements to receive loans and financial aid from financial institutions.                                                    | Founders could only enter into agreements to receive loans and financial aid from financial institutions in their own name.                                      |

## STRUCTURE 1 – SOLE PROPRIETORSHIP (PERUSAHAAN PERSEORANGAN OR “UD” OR PERUSAHAAN DAGANG OR “PD”)

### a. Overview

A sole proprietorship is a company established by one entrepreneur who has sufficient capital to undertake a business activity. The sole entrepreneur shall act as the owner and manager of the sole proprietorship and as a result, he/she shall be solely liable for any losses or debts that may arise from the sole proprietorship's business activities.

Indonesian laws do not specifically regulate sole proprietorship. The existence of sole proprietorship will depend on the founder's initiation and in practice, Indonesian business community acknowledged sole proprietorship as a business entity.

### Business line

There is no specific regulation on the types of business that may be carried out by a sole proprietorship. However, in practice, a sole proprietorship is usually used for trading activities under the name of a trading company.

### Source of capital

The main source of a sole proprietorship's capital is the personal assets of its owner. A sole proprietorship may also receive loans from third parties to support its activities.

### b. Advantages and Disadvantages

#### Advantages

- ✓ Establishment does not require any further ratification from any authority.
- ✓ The owner is fully entitled to all profits.

#### Disadvantages

- ✗ The liability of the owner is limitless.
- ✗ Limitation on source of financing.
- ✗ This entity cannot be founded by a foreign citizen or foreign entity.

### c. Establishment

There are no specific regulations that govern the establishment of a sole proprietorship under Indonesian law. However, in practice, a sole proprietorship in Indonesia is usually established under the following procedure:

- A. Sign a deed of establishment in the presence of a public notary.
  - B. Register the entity at the district court with jurisdiction over the entity's domicile.
  - C. Obtain a company registration certificate (“**TDP**”) from the relevant regional company registration office.
  - D. Register the entity with the district court with jurisdiction over its domicile.
  - E. Obtain a trade business license (“**SIUP**”) from the regional trading service office.
-

- F. Obtaining a business domicile certificate (“**SITU**”) from the regional government.
- G. Obtain a tax registration number (“**NPWP**”) from the relevant local tax office.

#### **d. Liability of the Founder**

The owner is personally liable for any loss or payment arising from the sole proprietorship’s activities.

#### **e. Tax Treatment**

Even though a sole proprietorship is not a legal entity, it is treated as an agency that is subject to tax in Indonesia. The profit of a sole proprietorship that will be distributed to the owner is not subject to income tax.

#### **f. Ongoing Governance and Regulatory Obligations**

A sole proprietorship is obliged to submit a report of its business activity, pursuant to its business license, to the government. The use of the entity’s profits for social or non-commercial purposes shall depend on the discretion of the owner.

#### **g. Structure of the Internal Organisations**

The internal structure of a sole proprietorship will depend on the owner’s discretion. The owner of the sole proprietorship may manage it personally or hire employees to assist him/her. The owner of a sole proprietorship shall be responsible for its management activities.

#### **h. Governance**

The owner of the sole proprietorship must be an Indonesian national/entity. A foreign national/entity cannot establish a sole proprietorship in Indonesia.

#### **i. Finance and Fundraising**

Financing and funding for a sole proprietorship arise from the capital injected by its owner and business profit. A sole proprietorship may also obtain loans from any financial institutions. Sole proprietorships are not allowed to collect public donations.

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## STRUCTURE 2 – PARTNERSHIP

### a. Overview

A partnership is an entity in which two or more individuals pool their resources and share profit and loss in accordance with a partnership agreement. All partnerships must have lawful objectives and must be conducted for the mutual benefit of the partners. Indonesian law prohibits the establishment of a partnership for the benefit of only one partner. Each partner is required to contribute funding, assets, manpower or expertise into the partnership.

### Business line

Theoretically, a partnership may undertake any business activity in Indonesia as long as it is not prohibited by the relevant prevailing regulations for its business sector. The regulations may also require a specific additional license or other requirements for.

### Source of capital

The main source of a partnership's capital is contribution from the partners. All partners provide contributions to the partnership pursuant to an agreement between themselves. A partnership may also receive loans from third parties to support its activities.

### b. Advantages and Disadvantages

#### Advantages

- ✓ Having more than one founder generally means that partnerships have more capital than sole proprietorships.

#### Disadvantages

- ✗ The partners are personally liable for the partnership's obligations to third parties.
- ✗ Partnerships cannot be founded by foreign citizens or entities.

### c. Establishment

The process for establishing a partnership is as follows:

- The founders sign an agreement to establish the partnership (deed of establishment). It is highly recommended to sign the agreement in a notarial deed format.
- The partnership is registered at the district court with jurisdiction over the partnership's domicile.
- The establishment of the partnership is announced in the State Gazette of the Republic of Indonesia ("State Gazette").
- The management of the partnership can then submit applications to obtain TDP, SIUP, SKDP and NPWP of the partnership to the relevant authorities.

### d. Liabilities of the Partners

All partners are personally liable for all of the obligations of the partnership to third parties. When dealing with third parties, a partner is deemed to act on his/her own behalf unless he/she has been granted a power of attorney by the other partners to act as their representatives.

#### **e. Tax Treatment**

A partnership is treated as an agency that is subject to applicable tax in Indonesia.

However, the profit of a partnership that will be shared between all of the partners is not subject to income tax.

#### **f. Ongoing Governance and Regulatory Obligations**

The partnership's partnership agreement will address the partnership's rules internally. It can include the rights and responsibilities of the management of the partnership. All profits arising in a partnership shall be distributed to all partners pursuant to the calculation set out in the partnership agreement. The partners are not permitted to use the profit directly for a social or non-commercial purpose prior to distributing such profits to all of the partners. However, each partner, in his/her discretion, may use his/her respective portion of the profit to fulfil a social or non-commercial purpose.

#### **g. Structure of the Internal Organisations**

There are no specific requirements under Indonesian law on the internal management structure for a partnership. The internal structure will depend on the partners' discretions, which is usually set out in the partnership agreement.

All partners are obliged to:

- A. provide contributions in the form of funding, goods, manpower, and/or expertise;
- B. be personally liable for the obligations of the partnership under any contract/agreement which they execute. A third party may only enforce an agreement against the executing partner. However, the executing partner may request for joint responsibility from the other partner(s) if he/she also acted for and on behalf all partners under a power of attorney; and
- C. indemnify the partnership for any losses which they may cause, without the right to set the indemnification off against the profit generated by the partnership.

All partners are entitled to:

- A. receive profit distributed in accordance with the partnership agreement or in proportion to the contribution provided by the relevant partner to the partnership; and
- B. manage the partnership, unless the partnership agreement appoints a specific partner to undertake the partnership's management.

#### **h. Governance**

The founders of the partnership must be Indonesian citizens. Foreign investors/foreign shareholders are not permitted to establish a partnership.

#### **i. Finance and Fundraising**

Financing and funding of a partnership arise from the capital contribution injected by all of its partners or from its business profits.

A partnership may also obtain loans from any financial institutions. The partnership is not allowed to collect public donations.

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## STRUCTURE 3 – FIRM

### a. Overview

A firm is a special form of partnership, which is established to operate a company (i.e. to gain profit) using a shared name. The company name may adopt the name of one or more of the partners, with or without additional wording, or any other name.

#### Business line

A firm may undertake any business activity in Indonesia as long as it is not prohibited by the regulations for that business sector. The regulations may also require a specific additional license or any other requirements for such business sector.

#### Source of capital

The main source of a firm's capital is the contribution from all of its partners. A firm may also receive loans from third parties to support its activities.

### b. Advantages and Disadvantages

#### Advantages

- ✓ The capital available to a firm is generally larger than that available to a sole proprietorship.

#### Disadvantages

- ✗ Each partner has unlimited liability for all debts incurred in the name of the firm.
- ✗ Loss caused by one partner shall be borne jointly and severally by all of the partners.
- ✗ The firm cannot be founded by foreign investor.

### c. Establishment

The process for establishing a firm is as follows:

- The deed of establishment is signed in a notarial deed format.
- The firm is registered at the district court with jurisdiction over the firm's domicile.
- Establishment of the firm is announced in the State Gazette.
- The management of the firm submits applications to the relevant authorities to obtain the firm's TDP, SIUP, SKDP and NPWP.

### d. Liabilities

Each partner of the firm has unlimited liability under all agreements entered into and activities conducted in the name of the firm. Each partner shall be jointly liable for the firm's loss. If a payment obligation is outstanding and payable to any third party, that third party may enforce it against any and all of the partners of the firm. Full payment of the obligation by one partner shall be sufficient to release the other partners from the obligation. In addition, a third party may still sue a partner who has resigned from the firm for any outstanding payment under any contract/agreement.

### e. Tax Treatment

A firm is treated as an agency that is subject to applicable tax in Indonesia. However, the profit of a firm that will be shared between all of the partners is not subject to income tax.

### f. Ongoing Governance and Regulatory Obligations

The firm's partnership agreement will address the firm's rules internally. It can include the rights and responsibilities of the firm's management. All profits arising in a firm shall be distributed to all partners pursuant to the calculation set out in the firm's partnership agreement. The partners are not permitted to use the profit directly for a social or non-commercial purpose prior to distribution to partners. However, each partner, in his/her discretion, may use his/her respective portion of the profit to fulfil a social or non-commercial purpose.

### g. Structure of the Internal Organisations

The partners, whether in the deed of establishment or in a separate deed, shall set out the name of the partner who is authorised to carry out the firm's management. It is advisable that the deed also names the partner(s) that can represent the firm before any third party. If the deed does not stipulate the firm's authorised representative, then all partners shall be deemed to have the right to represent the firm.

There are no other specific requirements under Indonesian laws on the internal management structure for a firm. The internal structure shall depend on the partners' discretion.

All partners are obliged to:

- G. provide contribution in the form of funding, goods, manpower and/or expertise; and
- H. be jointly and severally liable for all of the firm's debts under all contracts entered into with third parties in the name of the firm.

All partners are also entitled to:

- A. receive profit distribution in accordance with the firm's partnership agreement or in proportion to the contribution provided by the relevant partner to the firm;
- B. appoint one or more partners to be responsible for the management of the firm;
- C. review and control the firm's records;
- D. approve any new partners to be added into the firm;
- E. approve the replacement of a partner if the firm's partnership agreement provides for the replacement of a partner;
- F. sue the firm if a partner is also a creditor of the firm and to receive payment sourced from the firm's treasury;
- G. represent the firm before any third party, provided that the partnership agreement or any other deed executed by the firm do not appoint a specific partner as its authorised representative.

Management can only be carried out by a partner who is appointed to do so by the partnership agreement or any other deed executed by the firm.

**h. Governance**

The founders of the firm must be Indonesian citizens. Foreign citizen and foreign entities are not permitted to establish a firm.

**i. Finance and Fundraising**

Financing and funding of a firm comes from the capital contributions of its partners or from its business profits. A firm may also obtain loans from any financial institutions. The firm is not allowed to collect donations from the public.



## STRUCTURE 4 – LIMITED PARTNERSHIP (CV)

### a. Overview

Under Indonesian law, a CV is a company that is established by: (i) an individual or several individuals who are personally responsible for the company and all of its debts; and (ii) an individual or several individuals who merely provide contribution, financial or otherwise. In general, a CV is a firm with two types of partner:

- A. **Active partners** manage the CV and are personally liable for the CV's actions. The active partners are the representatives of the CV, therefore, any third parties must liaise only with these partners for any transactions involving the CV.
- B. **Silent partners** only contribute in the form of funding, goods or manpower for the operation of the CV, and do not manage the CV in its day-to-day business. Third parties often do not know of or have any information about the silent partner.

### Business line

There is no specific regulation on the types of business that may be carried out by a CV, and they may theoretically undertake any business activity. However, before conducting any business as a CV, the founders must check the regulations regarding their business activity to identify whether it can be carried out by a CV or not, and whether there are any licensing or other requirements.

### Source of capital

The main source of a CV's capital is the contribution from all of its partners. All partners provide their respective contributions as agreed between them. Any unpaid amount from a partner's contribution shall be considered as a debt owed to the CV. A CV may also receive loans from third parties to support its activities.

### b. Advantages and Disadvantages

#### Advantages

- ✓ The existence of a silent partner gives room to any party who wants to provide additional working capital to the CV without being involved in the CV's management.

#### Disadvantages

- ✗ No limit on the liability of each active partner for debts incurred in the name of the CV, while silent partners are only liable up to the amount of their individual contributions to the CV.
- ✗ Loss caused by one active partner shall be borne jointly and severally by all active partners, while silent partners' liability is limited to the amount of their respective contribution to the CV.
- ✗ Cannot be founded by foreign investors.

### c. Establishment

The procedure for establishing a CV is the same as the procedure for establishing a firm. Please refer to section (c) (iii) above.

#### **d. Liabilities of the Founders and the Internal Organisation**

##### **A. Active Partners**

The active partners shall be liable for all liabilities of the CV to third parties with their own assets. If the CV's assets are insufficient to cover its liabilities, then the active partners shall be jointly liable for the remaining amount of such liabilities with its own assets.

##### **B. Silent Partners**

The silent partners are only liable up to the amount of their individual contributions to the CV. Third parties are not able to enforce any of a CV's payment obligations against the personal assets of the silent partners. A silent partner who becomes involved in the management of the CV shall be immediately deemed as an active partner.

#### **e. Tax Treatment**

A CV is treated as an agency that is subject to applicable tax in Indonesia. The profit of a CV that will be distributed to all partners is not subject to income tax.

#### **f. Ongoing Governance and Regulatory Obligations**

The CV's partnership agreement will address the CV's rules internally. It can include the rights and responsibilities of the management of the CV. All profits arising in the CV shall be distributed to all partners pursuant to the calculation set out in the CV's partnership agreement. The partners are not permitted to use the profit directly for a social or non-commercial purpose prior to distribution of the profits. However, each partner, in his/her discretion, may use his/her respective portion of profit to fulfil a social or non-commercial purpose.

#### **g. Structure of the Internal Organisation**

The internal structure of a CV is determined in its partnership agreement, and the CV shall be managed by the active partners. The active partners may receive a salary and other benefits for their management duties.

#### **h. Governance**

The founders of a CV must be Indonesian citizens. Foreign investors/foreign shareholders are not permitted to establish a CV.

#### **i. Finance and Fundraising**

Financing and funding of a CV comes from the capital contributions by all of its partners or from its business profits. In addition, a CV may obtain loans from any financial institutions.

A CV is not allowed to collect donations from the public.

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## STRUCTURE 5 – FOUNDATION

### a. Overview

In Indonesia, a foundation is probably the most suitable form of a legal entity for a SE due to the inherent similarities with the purposes and objectives of a SE. In Indonesia, a foundation is known as a legal entity intended as a vehicle for attaining certain social, religious, or humanitarian purposes. However, what differentiates an SE from a foundation under Indonesian laws is that a foundation is not permitted to directly undertake any business activities as part of its main activities.

Indonesia recognises two types of foundation: (1) an Indonesian foundation, which is established under Indonesian laws; and (2) a foreign foundation, which is established under foreign law. Indonesian law treats Indonesian foundations differently from foreign foundations, especially in terms of their respective licensing and activity requirements. This chapter will only focus on Indonesian foundation.

#### No business activities

A foundation is not permitted to directly carry out any business activities in order to generate profits. Indonesian laws only allow a foundation to undertake non-commercial activities. However, a foundation may be indirectly involved in a business by (i) establishing a company (i.e., a PT), or (ii) participating in one or more business entities, provided that the activities of such entity are consistent with the purposes and objectives of the foundation, public order, ethics and prevailing laws. Further, the participation of such foundation in any business entity shall not be more than 25% of the foundation's total assets value and any surplus of the company must not be distributed to the organ of the foundation.

#### Source of capital

A foundation's capital can come from contributions from all of its founders, donations, benefaction assets (waqf, which is a donation of property given by Muslims to be held in trust and used for religious purpose), grants, grants under a will, and other sources that are not contrary to the foundation's AOA and prevailing laws.

#### Social activity

A foundation is established mainly for non-commercial purposes and to engage in social, religious, or humanitarian sectors, such as (i) formal and non-formal education, (ii) hospital and laboratory, (iii) research institutions, (iv) constructing and managing places of worship, (v) distributions of donation, (vi) disaster relief, (vii) environment protection or (viii) others.

### b. Advantages and Disadvantages

#### Advantages

- ✓ Not required to submit any reports to any government entities.
- ✓ Less complex to establish and relatively fast registration/establishment procedure.
- ✓ Subject to certain tax exemptions.

#### Disadvantages

- ✗ Limitation on the use of the foundation's funds.
  - ✗ Not permitted to engage in any commercial activities.
  - ✗ Obligated to prepare and publish source of funding.
-

### c. Establishment

A foundation may be established by Indonesian citizens, foreign citizens, Indonesian legal entities, or foreign legal entities. If a foundation is established by Indonesian citizens or entities, the initial assets of the foundation must be a minimum of IDR 10,000,000.

If at least one of the founders is a foreign entity or citizen, the initial assets of the foundation must be a minimum of IDR 1,000,000,000, and if the foundation is established by a foreign legal entity the initial assets of the foundation must be a minimum of IDR 10,000,000,000. The foreign founder must have been living for in Indonesia five consecutive years if it is an individual, or conducting activities in Indonesia for five consecutive years if it is entity.

The procedure for establishing a foundation is as follows:

- C. An application for the foundation's name is submitted to the Ministry of Laws and Human Rights ("MOLHR").
- D. The founders or their respective proxies sign a deed of establishment before a public notary.
- E. The public notary submits the signed deed of establishment to the MOLHR.
- F. The MOLHR will issue an MOLHR decree ratifying the establishment of the foundation and announce the deed of establishment in the State Gazette.
- G. the management of the foundation further submit applications to the relevant authorities in order to obtain a SKDP and a NPWP for the foundation.

The foundation will legally exist from the date of the issuance of MOLHR Decree.

### d. Liabilities of Internal Organizations

#### Board of Advisors

The board of advisors ("BOA") is responsible for evaluating the foundation's management, as conducted by the board of executives ("BOE"). Indonesian laws do not hold members of the BOA personally liable for any loss suffered by the foundation or any other party due to the foundation's management or activities.

#### Board of Executives

The BOE is in charge of all of the foundation's management activities. Each member of the BOE is personally liable for any loss of or damage suffered by the foundation and/or any third party as a result of its management.

In the event that the foundation is declared bankrupt, the members of BOE shall be jointly liable for the loss if (i) such bankruptcy is caused by the fault or negligence of the BOE in managing the foundation, and (ii) the foundation's assets are not sufficient to cover such loss. Any members of the BOE who could prove that the bankruptcy is not caused by his/her fault or negligence shall not be held liable for such loss with the other member(s) of the BOE.

#### Board of Supervisors

The Board of Supervisors ("BOS") is in charge of supervising the foundation's management activities, as conducted by the BOE. In the event that the foundation is declared bankrupt, the members of BOS shall be jointly liable for the loss if: (i) the bankruptcy is caused by the fault or negligence of the BOS in conducting its

supervisory duty; and, (ii) the foundation's assets are not sufficient to cover the loss. Any member of the BOS who can prove that the bankruptcy is not caused by his/her fault or negligence shall not be held liable for the loss with the other member(s) of the BOS.

#### **d. Tax Treatment**

A foundation receives certain tax benefits under Indonesian law. Most of its sources of funding (including any dividends from participation in a PT) are tax exempt, provided that there is no business or ownership relationship with the parties providing the funding.

#### **e. Ongoing Governance and Regulatory Obligations**

Within five months of the end of the foundation's financial year, the BOE must prepare an annual report containing, at least, a report on the foundation's activities for the relevant year and its financial statement. The report must be signed by the BOE and the BOS and approved by the BOA. The foundation must announce its annual report (including a financial statement audited by a public accountant) in a national newspaper, if:

- H. the foundation receives financial aid of IDR 500,000,000 or more in one financial year; or
- I. the foundation has assets (other than waqf assets) of IDR 20,000,000,000 or more.

Further, the foundation shall not distribute any dividends received from capital participation in any PT to the organ of the foundation.

#### **g. Structure of the Internal Organisations**

The internal organisations of a foundation must consist of three boards, namely the BOA, BOE and BOS.

No member of any board may hold simultaneous positions on two or more boards of the same foundation, or be a director or commissioner of a PT in which the foundation has capital participation. The members of the BOE and BOS are appointed for a 5-year term and such term may be extended, unless he/she is dismissed based on the decision of the BOA's meeting at any time after his/her appointment. There is no prescribed term of office for BOA members. Any change to the composition of any board shall be reported to the MOLHR.

Further, any foreign board members must also obtain Indonesian working permits to undertake their duties in the foundation.

#### **Board of Advisors**

The BOA may consist of one or more members. If there is more than one advisor in the foundation, one of them must be appointed as the chairman. Foreign individuals may be appointed as members of the BOA as long as they have been living in Indonesia for five consecutive years and hold valid stay permits.

The obligations and rights of the BOA are as follows:

| Obligations                                                                                                                                                                                                                                                                                                                             | Rights                                                                                                                                                                                                                                                                                                                                                                                     |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ol style="list-style-type: none"> <li>1) Hold a meeting at least once a year to evaluate the finance and liabilities of the foundation on the previous year as a basis of consideration for the foundation's development in the following year.</li> <li>2) Report any change to the BOE and BOS compositions to the MOLHR.</li> </ol> | <ol style="list-style-type: none"> <li>1) Decide on amendments to the AOA.</li> <li>2) Appoint and dismiss members of the BOE and BOS.</li> <li>3) Set out the general rules of the foundation based on the AOA.</li> <li>4) Approve the work program and the draft annual budget of the foundation.</li> <li>5) Make decisions on any merger or dissolution of the foundation.</li> </ol> |

### Board of Executives

The foundation shall be managed by the BOE, which shall consist of at least a chairman, a secretary and a treasurer. If there is more than one executive appointed to the BOE, one of them must be appointed as the general chairman.

If one of the founders is a foreign citizen/entity, it must be ensured that at least the chairman, secretary or treasurer of the foundation is an Indonesian citizen.

Members of the BOE may receive a salary from the foundation in order to ensure professionalism in the foundation's management.

The general obligations and rights of the BOE are as follows:

| Obligations/Duties                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | Rights/Authorities                                                                                                                                                                                                                                                                                                                                                                                                           |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ol style="list-style-type: none"> <li>1) Manage the foundation.</li> <li>2) Keep records of any information regarding the obligations, rights, and any other information related to the foundation's business activities.</li> <li>3) Keep records of the foundation's financial affairs in the form of accounting and other supporting financial administrative documents.</li> <li>4) Prepare an annual report within five months of the closing date of the previous financial year. The annual report shall contain at least: (1) the foundation's business activities and achievements in the previous financial year; and, (2) the foundation's financial report, which contains the foundation's financial position in the last year, activities report, cash flow report and financial notes.</li> </ol> | <ol style="list-style-type: none"> <li>1) Represent the foundation both before and outside any court.</li> <li>2) Appoint and dismiss the foundation's activity organizer.</li> <li>3) Propose extensions of the term of the foundation.</li> <li>4) Sign the foundation's annual report.</li> <li>5) Propose mergers to the BOA.</li> <li>6) Act as a liquidator in the event that the foundation is liquidated.</li> </ol> |

The AOA of the foundation may set out other obligations/duties and rights/authorities of the BOE. Further, members of the BOE are prohibited from taking any of the following actions:

- A. representing the foundation if:
  - (aa) there is a lawsuit between the foundation and that member of the BOE; or
  - (bb) there is conflict of interest between the foundation and that member of the BOE;
- B. binding the foundation as a guarantor of a loan;
- C. transferring assets of the foundation, unless approved by the BOA;
- D. using the foundation's assets as security for the benefit of any third party; and
- E. other prohibitions provided in the AOA of the foundation.

### Board of Supervisors

The BOS is responsible for the supervision of the management and foundation activities conducted by the BOE. The BOS must consist of one or more members. Members of the BOS do not receive a salary from the foundation.

The general obligations and rights of the BOS are as follows:

| Obligations/Duties                                                      | Rights/Authorities                                                                           |
|-------------------------------------------------------------------------|----------------------------------------------------------------------------------------------|
| 1) Supervise the management of the foundation, as conducted by the BOE. | 1) Provide advice to the BOE on the foundation's business activities.                        |
| 2) Inspect any of the foundation's financial documents.                 | 2) Temporarily dismiss any member of the BOE by disclosing the reason behind such dismissal. |
| 3) Be aware of every action taken by the BOE.                           |                                                                                              |

### h. Governance

There is no prohibition against foreigners sitting on the management board of the foundation.

### i. Finance and Fundraising

A foundation is allowed to receive foreign grants from various donors from time to time. A foundation must publish a summary of its annual report by posting it on the announcement board at the foundation's office. The report shall be audited and announced in an Indonesian daily newspaper if the foundation:

- A. receives national or international aid and/or third party aid of IDR 500,000,000 or more, within a financial year; or
- B. obtains any asset other than benefaction assets in the amount of IDR 20,000,000,000 or more.

A foundation, unless established by foreign entity, is allowed to conduct fundraising by collecting donations from the public after obtaining a fundraising permit from any of the following authorities:

- A. The Ministry of Social Affairs ("MSA"), for any fundraising activities that are conducted nationally or in more than one province, or if the fundraising is purported for any offshore social activities.
- B. A provincial governor, for any fundraising activities conducted only within one province.
- C. The regent, for any fundraising activities conducted only within one regency.

## STRUCTURE 6 – ASSOCIATION

### a. Overview

An association is a legal entity consisting of individuals which is established to pursue certain social, religious or humanitarian purposes and objectives and does not distribute profit to its members. Compared to other legal entities, an association is not thoroughly regulated under Indonesian law. This is due to the absence of a specific law governing associations, unlike other legal entities. A bill concerning associations was formulated in 2015, but it is unclear when the final bill will come into effect. Nonetheless, the procedure for establishing an association is covered by several government regulations.

### No Business Activities

An association is a non-profit oriented entity and it could not engage in any business activity. However, it can invest in a PT.

### Sources of Capital

An association's capital comes from the contributions of its founders, donations, members' deposits, grants, grants under a will and/or other sources that are not contrary to the foundation's AOA or the law.

### Membership

Members of the association shall be validated by the association's BOM, as evidenced by a membership card. Each member must pay a membership deposit pursuant to the association's AOA.

### b. Advantages and Disadvantages

#### Advantages

- ✓ Not required to submit any report to any government entities.
- ✓ Less complex and relatively fast registration/establishment procedure.
- ✓ The main purpose focuses on social benefit.

#### Disadvantages

- ✗ Not permitted to engage in any commercial activities.
- ✗ Not subject to certain tax exemptions.

### c. Establishment

The procedure for establishing an association is as follows:

- A. Apply to the MOLHR for the proposed name of the association.
- B. The founders or their authorized proxies sign the deed of establishment before a public notary.
- C. The public notary submits the signed deed of establishment to the MOLHR, together with other required documents, to obtain ratification.

The association shall legally exist from the issuance date of MOLHR ratification.

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#### **d. Liabilities**

Members of an association or an association's BOM and BOS are not personally liable for any agreement in relation with the association.

#### **e. Tax Treatment**

Associations are subject to certain tax liabilities, such as income tax and value-added tax. Associations do not enjoy any special tax treatment.

#### **f. Ongoing Governance and Regulatory Obligations**

The association's AOA must address the association's internal rules. It can include the rights and responsibilities of the management of the association. The activities of an association will vary, but must meet the non-commercial social, religious, or humanitarian purposes for which the association was established. The social activities and social purpose shall be written in the deed of establishment of an association.

#### **g. Structure of the Internal Organisations**

An association shall consist of the following three internal organisations: (A) the meeting of the members of the association ("MMA"), which has the highest power in an association and can decide on management and operational policies; (B) the BOM, which manages and operates the association; and, (C) the BOS, which gives advice to the BOM in operating the association.

##### **A. MMA**

An MMA is convened by the BOM and shall be attended by members of the association. An MMA has the highest power in an association and may decide on the management and operational policies of such association. An MMA may adopt resolutions by way of consensus or by simple majority vote.

There are two types of MMA: (i) annual MMAs, which are convened no later than six months after the end of the association's accounting year, mainly to hear and approve or reject the BOM's annual report; and (ii) extraordinary MMAs, which can be held at any time.

In the MMA, each member of the association shall have equal voting right, unless the AOA provides otherwise. The MMA's decision is based on consensus or simple majority vote.

##### **B. BOM**

Members of the BOM are appointed at an MMA from and by the members of the association. Members of BOM at least shall consist of a Chairman, a Secretary and a Treasurer. Requirements that must be fulfilled by an individual in order to be a member of the BOM are stipulated in the association's AOA. Any BOM member may be temporarily terminated by the BOS if such member acts in a contradictory manner with AOA and /or prevailing laws and regulations.

The Chairman and one member of the BOM may represent the association before and outside any court of law.

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C. BOS

Members of the BOS are appointed from and by the members of the association in an MMA.

Requirements that must be fulfilled by an individual in order to be a member of the BOS are stipulated in the association's AOA.

**h. Governance**

There is no prohibition against foreigners being members of an association.

**i. Finance and Fundraising**

The association is allowed to conduct fundraising by collecting donations from the public after it obtains a fundraising permit from any of the following authorities:

- A. the MSA, for any fundraising activities that are conducted nationally, in more than one province, or for any offshore social activities; or
  - B. the provincial governor, for any fundraising activities conducted only within one province; or
  - C. the regent, for any fundraising activities conducted only within one regency.
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## STRUCTURE 7 – COOPERATIVE

### a. Overview

A cooperative is an autonomous association of individuals who voluntarily unite their economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. The members of a cooperative are the owners and also the service users of the cooperative. The cooperative's activities are based on the principle of cooperation, such as voluntary and open membership, democratic member control, fair distribution of net income based on the services conducted by each member and limited remuneration towards capital and independency. The purpose of a cooperative is to improve the welfare of its members and the local community.

Recently, cooperatives in Indonesia have begun calling themselves SEs since the principles and purposes of cooperatives are similar to the values of social enterprise. Similar to an SE, a cooperative needs to balance the pursuit of profit against the economic needs and interests of the cooperative's members and their communities.

A cooperative is particularly attractive for small-scale entrepreneurs who have business potential but have small capital. Through a cooperative, small entrepreneurs can pool their capital to accommodate the development of their respective businesses or their economic needs.

Cooperatives are divided into two categories:

- A. **Primary cooperatives:** cooperatives established and made up by at least 20 Indonesian citizens who have the same business activities (e.g., farmers).
- B. **Secondary cooperatives:** cooperatives established and made up by at least three primary cooperatives.

### Business line

The type of business conducted by a cooperative shall be determined based on the economic needs of its members. In this respect, a cooperative may undertake one business activity or several business activities in the production, distribution, marketing, services, credits and savings sectors and/or other business activities, based on conventional or Sharia economic principals.

Certain business activities are subject to licensing requirements, and cooperatives may only operate in certain business sectors.

Examples of activities that a cooperative may conduct in order to develop the economic interest of its members include:

- providing loans to its members or community members using simple procedures and low interest;
  - providing certain goods and materials based on the needs of its members;
  - activities involving the sale of products produced by its members.
-

## Sources of capital

A cooperative may obtain capital from equity, debt capital, or capital participation from its members.

### Equity

A cooperative can obtain equity through:

- principal deposits paid by each member upon admission. This deposit cannot be withdrawn by a member during his/her membership;
- mandatory periodic deposits from members. The amount of the mandatory deposit varies for each member. This deposit cannot be withdrawn by a member during his/her membership;
- reserved funding, which is reserved from the cooperative's revenue for its own capital to cover any loss suffered by the cooperative (if relevant); and
- donations from individuals and/or other entities.

### Debt Capital

A cooperative may also obtain debt capital from the following parties or methods:

- its members, including any prospective members who fulfil the relevant membership requirements;
- other cooperatives or their members based on a cooperation agreement between the cooperatives;
- a bank or any other financial entity, subject to the prevailing laws;
- by issuing bonds or other promissory notes in accordance with the prevailing laws; and
- any other lawful source, such as a loan from a non-member under a non-public offering.

### Capital Participation

Capital participation means participation in the capital of a cooperative by providing funding and/or goods that can be valued financially by investors in order to increase and strengthen the capital of the cooperative and to increase its business activities. Capital participation may be provided by the government, citizens, business entities and/or other entities based on an agreement.

## Membership

A cooperative's members are its owners, as well as its customers or service users. The membership in a cooperative shall be recorded in a Membership Registry Book managed by the BOM. A primary cooperative is required to have at least 20 Indonesian citizens as its members, while a secondary cooperative must at least have three other cooperatives as its members.

Membership of a cooperative shall be based on similar economic interest within the scope of that cooperative's business operation. Acceptance and termination of membership shall be based on the provisions of the cooperative's AOA and determined by its BOM.

Any prospective member who has not fulfilled all of the membership criteria under a cooperative's AOA, or any foreign citizen who intends to be a member of a cooperative, may be accepted as an extraordinary member pursuant to any specific requirements, rights, and obligations provided in the cooperative's AOA.

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Membership is not transferable and may be terminated for any of the following reasons:

- (aa) voluntarily resignation by the member;
- (bb) removal of the member by the BOM for no longer fulfilling the membership criteria under the cooperative's AOA, defaming the cooperative's reputation, or causing any loss to the cooperative;
- (cc) the member has passed away; or
- (dd) the cooperative has been dissolved.

## b. Advantages and Disadvantages

### Advantages

- ✓ profit-oriented to improve the welfare of the cooperative's members;
- ✓ empowerment of human resources (member of cooperatives);
- ✓ less complex and relatively fast registration/establishment procedure; and
- ✓ the required capital is relatively low.

### Disadvantages

- ✗ no special tax treatment;
- ✗ relatively difficult to expand the business due to limitation in source of funding; and
- ✗ non-competitive.

## c. Establishment

### Requirements

A cooperative must:

- (aa) be established by 20 Indonesian citizens (for a primary cooperative) or 3 existing cooperatives (for a secondary cooperative);
- (bb) conduct a business activity that directly and economically benefits its members;
- (cc) have divided its business into three: its main business, supporting business, and supplementary business, and stipulated it in its AOA; and
- (dd) have received fully paid-up membership deposits from the founders.

### Procedure

The procedure for establishing a cooperative is as follows:

- (aa) The founders invite all potential founders to a meeting to discuss the content of the cooperative's AOA, which is documented in a minutes of meeting.
  - (bb) An application for the cooperative's proposed name is submitted to the relevant authority.
  - (cc) The deed of establishment and AOA are signed, in a notarial deed format, before a notary.
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- (dd) The notary submits an application for approval of the cooperative's deed of establishment, along with accompanying documents, to the Ministry for Cooperative and Small and Medium Scale Entrepreneurs ("**MOC**").
- (ee) The MOC issues a decree ratifying the cooperative's deed of establishment, or rejects the application in writing, within three months of submission. If the application is rejected, the founders may submit a second application. The MOC's decision on the second application shall be final and the founders cannot submit the same application again.
- (ff) The MOC announces the establishment of the cooperative in the State Gazette and registers the cooperative in the public register of cooperatives.
- (gg) The management of the cooperative submit applications to the relevant authorities in order to obtain the cooperative's SKDP, TDP, and NPWP.

A cooperative shall be deemed to be a legal entity under Indonesian law once it receives its deed of establishment is ratified by the MOC.

#### **d. Liabilities**

The members of the BOM has an extended liability towards the cooperative compared to all of the cooperative's other internal organisations. Each member of the BOM may be required to, either jointly with the other members of the BOM, or individually, be responsible and personally liable for any loss or damage suffered by the cooperative due to his/her negligent or omission in conducting his/her duties.

In addition, a member of the BOM may also be personally liable for any loss or damage caused by his/her intentional mistake. The liabilities of the MMA, the members and the BOS are provided in the cooperative's AOA.

#### **e. Tax Treatment**

A cooperative is subject to certain tax liabilities, such as on income tax and value-added tax. Pursuant to the prevailing taxation laws in Indonesia, cooperatives do not enjoy any special tax treatment.

#### **f. Ongoing Governance and Regulatory Obligations**

The cooperative's AOA addresses the cooperative's rules internally. It can include the rights and responsibilities of the management of the cooperative.

By the end of each financial year, the cooperative shall prepare an annual report, which must be signed by the MMC. Such report must contain at least the annual calculation of the cooperative, which comprised of the balance sheet from the last financial year and the ongoing financial year and the cooperative's condition and its business surplus.

The MMC may stipulate the distribution of the amount of the cooperative's surplus to the cooperative members and the amount of surplus that will be used for training and/or other purpose for the benefit of the cooperative.

#### **g. Structure of the Internal Organisations**

A cooperative shall consist of three internal organisations, namely, (1) MMC, which has the highest power in a cooperative and may decide on the management and operational policies of such cooperative, (2) BOM,

which manages and operates the cooperative and (3) BOS, which supervises the implementation of policies and management in such cooperative. In addition, the BOM may appoint a business manager (the “**Business Manager**”) to assist the management and operation of the cooperative’s business unit.

#### C. MMC

An MMC is convened by the BOM and shall be attended by members of the cooperative. The MMC has the authorities that are not given to the other boards of the cooperative to take, among others, the following actions:

- (aa) determining the provisions of the cooperative’s AOA;
- (bb) set out the general policies on the management and operation of the cooperative;
- (cc) nominating, appointing and dismissing members of the BOM and BOS;
- (dd) approving the work plan and budget plan and ratifying the cooperative’s financial statement;
- (ee) holding the BOM accountable for the management of the cooperative;
- (ff) ratifying the responsibility report of the BOM;
- (gg) distribution of profit; and
- (hh) undertaking merger, consolidation, demerger or dissolution of the cooperative.

The resolution of MMC is adopted by way of consensus or by a simple majority vote.

MMC consists of (i) annual MMC, which must be held no later than 6 months after the end of the financial year of the cooperative and (i) extraordinary MMC, which may be held at any time.

#### D. BOM

The members of BOM are appointed from and by the members of the cooperative in an MMC. When a cooperative is first established, the composition and the names of each members of the BOM shall be stipulated in its deed of establishment. The maximum term of office of the members of the BOM is 5 (five) years.

Requirements that must be fulfilled by an individual in order to be a member of the BOM are stipulated in the cooperative’s AOA.

#### E. BOS

The members of BOS are appointed from and by the members of the cooperative in an MMC. When a cooperative is first established, the composition and the names of each member of the BOS shall be stipulated in its deed of establishment. The maximum term of office of the members of the BOS is 4 (four) years.

Requirements that must be fulfilled by an individual in order to be a member of the BOS are stipulated in the cooperative’s AOA.

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#### **F. Business Manager**

The Business manager is appointed by BOM to assist the BOM in conducting the management and operation of the cooperative. The Business Manager is responsible to the BOM and the relationship between the BOM and the Business Manager is a cooperation based on an agreement.

There is no requirement for a cooperative to have a Business Manager and whether a Business Manager is appointed in a cooperative shall be subject to the discretion of the BOM and MMC's approval. The appointment of a Business Manager does not waive the liability of BOM over the business unit managed by such Business Manager.

#### **h. Governance**

The members of a cooperative must be Indonesian citizens. Foreigners are prohibited from becoming a member of a cooperative.

#### **i. Finance and Fundraising**

There are two types of capital participations in a cooperative, namely, capital participation and Sharia capital participation (collectively referred to as "Capital Participation"). A cooperative can obtain Capital Participation from the government, members of the cooperative, the society, any legal entities and any business entities. Any party who funds a cooperative through Capital Participation shall not receive any voting right in an MMC. Only a cooperative that has convened an MMC for the last two successive years and fulfilled other requirements under Indonesian law can receive and manage Capital Participation.

Business activities funded through Capital Participation are managed by the cooperative. The relevant investors may also participate in the management of such activities if it has been agreed in writing between the cooperative and the investors beforehand. The provider of the Capital Participation shall be entitled to receive distributed profits from the business activities funded by their Capital Participation.

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## PT

### a. Overview

A PT is a commercial business entity whose main goal is to make profit, and is the most common type of company in Indonesia. At first glance a PT may not seem to be a type of legal entity that can be utilised by an SE, as an SE requires most of its profits to be used for social purposes. However, this does not mean that the concept of PT cannot be adjusted based on the spirit of SE.

While it is not common, it is possible for a PT to arrange its AOA to state that the profits generated by the PT shall be utilised not as dividends, but rather, for social purposes. This way, a PT can operate just like a SE. Alternatively, a PT may also arrange its AOA so that the majority of its profits are used for corporate social responsibility programs.

### Business line

A PT may undertake any business activities in Indonesia by obtaining the relevant business license from the government and/or fulfilling the prevailing regulatory requirements. There are limitations on capital participation of a foreign investment company ("PT PMA") that conduct certain business activities.

### Source of capital

The main source of a PT's capital is issued capital in the form of shares, held by the shareholders in the amount set out in the PT's AOA. The issued capital must be paid-up in full by the shareholders immediately. For a PT PMA, the capital structure must be a minimum of:

- A. IDR 10,000,000,000 (ten billion Rupiah) (excluding building and land) in authorized capital; and,
- B. at least IDR 2,500,000,000 (two billion five hundred million Rupiah) in issued and paid-up capital.

In addition, the participation of each shareholder in a PT PMA must be at least IDR 10,000,000 (ten million Rupiah).

A PT may also use any other sources of financing, including loans from third parties, to support its activities, or issue securities to obtain additional working capital.

### b. Advantages and Disadvantages

#### Advantages

- ✓ Can conduct various line of business
- ✓ Wide variety of options for financing and raising funds, e.g., foreign investor participation, initial public offering, loans etc.

#### Disadvantages

- ✗ Relatively complex and long registration/establishment procedure, especially for PT PMAs
- ✗ Relatively expensive

### c. Establishment

The procedure for establishing a PT is as follows:

- A. An application is made to the MOLHR for the proposed name of the PT.
- B. An account is created on the online system of the Indonesia Investment Coordinating Board (*Badan Koordinasi Penanaman Modal* or “**BKPM**”), in preparation for step (c), below.
- C. An application for principal approval from the BKPM is made through BKPM’s online system.
- D. The deed of establishment is prepared by the founders or their authorized proxies and signed before a public notary.
- E. The public notary submits the signed deed of establishment and other requirements to the MOLHR to obtain ratification.
- F. The PT’s NPWP makes an application to the relevant tax office.
- G. The PT opens a bank account.
- H. The PT’s TDP applies to the relevant regional Trade Service Office.
- I. The MOLHR announces the PT’s deed of establishment in the State Gazette and Supplement to the State Gazette by.

A PT is deemed to legally exist from the date of issuance of the MOLHR ratification.

### d. Liabilities

#### Shareholders

In principal, a shareholder’s liability is limited to the amount that they have invested in the company and for any unpaid amount on such shareholder’s shares in the company (if any). However, a shareholder may be personally liable if:

- (aa) they undertake a certain action that could lead into the ‘piercing of the corporate veil’; or
- (bb) they are acting as a personal guarantor by virtue of a personal guarantee agreement.

#### Board of Directors (“BOD”)

In general, members of the BOD are not personally liable for any liability of the PT, except for:

- (aa) any loss suffered by the company if he/she acts negligently or fails to perform his/her duties in good faith and with full responsibility; and
- (bb) the insufficiency of the PT’s assets to cover the liabilities incurred during the PT’s bankruptcy process, caused by the BOD.

#### Board of Commissioners (“BOC”)

Every member of the BOC will be held personally liable for every loss suffered by the PT if he/she acts negligently or fails to perform his/her duties in good faith, prudently, and responsibly. In the event that there is more than one commissioner in the BOC, then the abovementioned liability shall apply jointly to all members of the BOC.

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### e. Tax Treatment

In general, there is no specific tax treatment to a PT, except for a PT which is registered in BKPM as a domestic or foreign investment company that may apply for an import facility from the government. The granting of such import facility is dependent on the PT fulfilling specific requirements and the discretion of the government.

### f. Ongoing Governance and Regulatory Obligations

The annual General Meeting of Shareholders ("**GMS**") may only distribute dividends and allocate parts of the profit for social purposes if the following conditions have been fulfilled:

- A. The PT has a positive net balance in the relevant financial year. Positive net balance means that the PT's net profit in the relevant financial year is sufficient to cover any of the company's accumulated losses from the previous financial years. Net profit means the PT's revenue in one financial year minus taxes.
- B. The annual GMS has set aside a specific amount of the net profit for the company's reserve funds. Part of the net profit may be set aside for reserve funds until they reach at least 20% of the PT's issued and paid-up capital.

A PT's profits may be used for social purposes through the following means:

- A. Company Social Responsibility ("**CSR**") program

A PT may use its profits for social purposes through its CSR program, with the amount to be spent on the CSR program determined by the GMS. The advantages of using a CSR program are, amongst others: (i) expenses spent for the CSR program shall be considered as operational expenses of the PT; and, (ii) Indonesian laws does not specifically set a maximum amount of expenses that a PT can spend on its CSR program.

- A. Shareholders' discretion on dividend

A shareholder may utilise all or part of their dividend to finance social activities outside the company. To streamline the process, a shareholder may issue a power of attorney or instruction to the PT to directly transfer it to another account for the purpose of social activities.

### g. Structure of the Internal Organisations

A PT must have a GMS, BOD and BOC.

#### **GMS**

GMS is the organisation of a company that holds certain powers that are not given to the BOD or BOC, as determined by Law No. 40 of 2007 regarding Limited Liability Companies (the "**Company Law**") and/or the Company's AOA. These include:

- (aa) approving the company's annual report and the use of the PT's profit;
- (bb) ratifying the annual report of the BOD regarding the management of PT;
- (cc) approving the transfer or encumbrance of more than 50% of the total assets of the company;
- (dd) approving the merger, acquisition, demerger, consolidation, liquidation and dissolution of the company;

- (ee) approving amendments to the PT's AOA;
- (ff) approving the appointment or dismissal of the members of BOD and BOC;
- (gg) approving the change of the PT's status from a private company into a public company and changes to the shareholders composition;
- (hh) setting out the PT's general management and operational policies; and
- (ii) other powers that may be provided in the AOA.

The GMS is convened by the BOD. One or more shareholders who jointly represent at least 1/10 (one tenth) or more of the total number of shares with voting rights may request that the company convene a GMS.

### **BOD**

The BOD is responsible for the management of a company in accordance with its purposes and objectives. Members of the BOD are authorized to represent the company, including in court, pursuant to the provisions in the AOA.

### **BOC**

The BOC is mainly responsible for supervising the management and operation of the company, as undertaken by the BOD, and for providing advice to the BOD. The BOC is responsible for its supervision duties to the GMS.

The PT's AOA may require the BOD to obtain the BOC's consent before entering into any transaction or taking any action on behalf of the PT.

## **h. Finance and Fundraising**

Financing and funding a company can be done in various ways, including but not limited to, capital increase, obtainment of loans from any financial institutions and issuance of securities. A PT is not allowed to collect donation from the public.

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## SUMMARY

We provide the following table as comparison for the existing entity structures available for the SE:

|                     | Sole Proprietorship                                                                                    | Partnership                                                                                                                        | Firm                                                                                      | CV                                                                                                                                                                                                                                                  | Foundation                                                                                                                                 | Association                                                                                                                                                                         | Cooperative                                                                                                                                                                                          | PT                                                                                                                                                                            |
|---------------------|--------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Overview            | An entity established by one entrepreneur who has sufficient capital to undertake a business activity. | An entity where two or more individuals pool their resources and share profit and loss in accordance with a partnership agreement. | A special form of partnership established to operate and gain profit using a shared name. | An entity established by: (a) an individual or several individuals who are responsible for the company and all its debts, with its own assets; and (b) an individual or several individuals who only provide contributions, financial or otherwise. | A legal entity to carry out specific social, religious, or humanitarian activities.                                                        | A legal entity consisting of individuals, established to pursue certain social, religious and humanitarian objectives, which does not distribute profit to its members or founders. | An autonomous association of individuals who voluntarily choose to unite their economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. | A commercial business entity whose main goal is to make profit. The most common type of company in Indonesia.                                                                 |
| Business Activities | Vary – as long as the business line may legally be conducted by a sole proprietorship.                 | Vary – as long as the business line may legally be conducted by a partnership.                                                     | Vary – as long as the business line may legally be conducted by a firm.                   | Vary – as long as the business line may legally be conducted by CV.                                                                                                                                                                                 | No business activities.                                                                                                                    | No business activities.                                                                                                                                                             | Vary – as long as may legally be conducted by a cooperative and is based on the economic needs of its members.                                                                                       | Vary – as long as the business line may legally be conducted by a PT.                                                                                                         |
| Sources of Capital  | The personal assets of the owner and business revenue.                                                 | Contributions from all partners and business revenue.                                                                              | Contributions from all partners and business revenue.                                     | Contributions from all partners and business revenue.                                                                                                                                                                                               | Contributions from all founders, donations, benefaction assets and other sources that are not contrary to the foundation's AOA or the law. | Contributions from all founders, donations, members' deposits, grants, grants under a will and/or other sources that are not contrary to the foundation's AOA or the law.           | Membership deposits, debt capital or capital participation from members.                                                                                                                             | Share capital held by the shareholders.                                                                                                                                       |
| Social Activities   | At the discretion of the owner.                                                                        | At the discretion of each partner.                                                                                                 | At the discretion of each partner.                                                        | At the discretion of each partner.                                                                                                                                                                                                                  | Yes. The utilisation of the foundation income is solely for the social purpose set out in the AOA.                                         | Yes. The utilisation of the association income is solely for the social purpose set out in the AOA.                                                                                 | The social aspect of the cooperative is that its business operations are intended to support the small-scale businesses of its members and the local communities.                                    | In order to use profit for social purposes, a PT can undertake CSR programs or, at its shareholders discretion, the PT's net profit may be used to finance social activities. |

|               | Sole Proprietorship                                                                                            | Partnership                                                                                                        | Firm                                                                                                               | Limited partnership ("CV")                                                                                         | Foundation                                                                                                                                               | Association                                                                                                                                                | Cooperative                                                                         | Limited Liability Company ("PT")                                                                                                  |
|---------------|----------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|
| Liability     | Unlimited.                                                                                                     | Unlimited.                                                                                                         | Unlimited.                                                                                                         | Active partners: unlimited.<br>Silent partners: limited.                                                           | Limited.                                                                                                                                                 | Limited.                                                                                                                                                   | Limited.                                                                            | Limited.                                                                                                                          |
| Tax Treatment | Subject to the applicable tax in Indonesia. However, the profit received by the members is not subject to VAT. |                                                                                                                    |                                                                                                                    |                                                                                                                    | Tax exempt.                                                                                                                                              | Subject to the applicable tax in Indonesia. No special tax treatment.                                                                                      |                                                                                     |                                                                                                                                   |
| Financing     | a. Capital injected by its owner<br>b. Business revenue<br>c. Loan facility from any financial institution     | a. Capital contributions of all partners<br>b. Business revenue<br>c. Loan facility from any financial institution | a. Capital contributions of all partners<br>b. Business revenue<br>c. Loan facility from any financial institution | a. Capital contributions of all partners<br>b. Business revenue<br>c. Loan facility from any financial institution | a. Contributions from all founders<br>b. Donations<br>c. benefaction assets<br>d. Other sources that are not contrary to the foundation's AOA or the law | a. Contributions from all founders<br>b. Donations<br>c. Benefaction assets<br>d. Other sources that are not contrary to the association's AOA or the law. | a. Membership deposits<br>b. Debt capital<br>c. Capital participation from members. | Various methods, including but not limited to capital increase, loans from any financial institution, and issuance of securities. |
| Fundraising   | Prohibited from collecting donations from the public.                                                          |                                                                                                                    |                                                                                                                    |                                                                                                                    | May collect donations from the public after it obtains a permit from the relevant authorities (excluding foundations established by foreign entities).   | Prohibited from collecting donations from the public.                                                                                                      |                                                                                     |                                                                                                                                   |

## RECOMMENDATION

In conclusion, social entrepreneurs who wish to establish a SE in Indonesia must consider whether the SE will carry out social activities and business activities under one entity or two different entities (hybrid arrangement).

The benefit of conducting both social and business activities under one entity is that the social activities can obtain funds directly from the operational funds of the SE whenever it is deemed necessary to do so by the SE's management. The funds that are accommodated for the social activities will be considered part of the company's operational expenses and this will be excluded from its taxable revenue. However, the disadvantage of this arrangement is that the existence of this entity will depend on the performance of the business activity. If the business activity collapses, and such collapse results in the liquidation or dissolution of the SE, then social activities conducted by the SE will also cease. Moreover, the SE's assets will also be available to be pledged as security for the SE's financial liabilities. Social entrepreneurs who have decided to establish one entity can establish the SE in the form of sole proprietorship, partnership, firm, CV, cooperative and PT.

The risks mentioned above could be minimized by using the hybrid arrangement, where the social entity is separated from the business/profit-oriented entity. In Indonesia, the hybrid theory may be implemented by establishing a foundation or an association, which will carry out the social activities, while the business activities are conducted by a PT. Under this arrangement, the foundation/association will own the PT jointly with the other founder(s). Some advantages of the hybrid scenario include:

- since the foundation/association and the PT are separate entities before the law, the foundation/association will not be responsible for any liability of the PT;
- the foundation/ association's assets cannot be used as securities for the fulfilment of the financial liabilities of the PT, except for its capital contribution to the PT;
- if the PT is liquidated/dissolved, it will not affect the existence of the foundation/Association and the foundation/association can continue its social activities; and
- the foundation/association does not need to bear all of the costs (including the capital contribution) for the establishment/management of the PT since the PT will be established jointly with other investors.

However, there is a disadvantage to this hybrid arrangement relating to the flow of funds from the PT to the shareholders, including the foundation/association. As elaborated above, a PT may only distribute dividends to its shareholders in a financial year if the PT has a positive net profit in that year, and the PT has allocated part of the profits as the PT's reserve funds. Since a PT may only distribute dividend to its shareholders after the completion of a financial year, the foundation/association will only obtain funds from the PT once in a year. The BOD of the PT could distribute interim dividends to the foundation/association and the other shareholders before the completion of its financial year, with the risk that the foundation/association would be required to refund that interim dividend to the PT if, at the following annual GMS, the PT declared that the company has suffered financial losses during the financial year.

Further, the hybrid arrangement requires more initial costs in the as there will be two entities to establish. The hybrid arrangement may also require more employees and other resources for the management, operation and supervision of both entities, as Indonesian law prohibits both entities being managed by the same individuals.

## CASE STUDIES

### TRANSFORMING TO A CORPORATION: THE CASE OF PT SOBI

PT Sosial Bisnis Indonesia (SOBI) was established in 2016 by Telapak with the mission of using a business minded approach and the power of the market to solve social and environmental issues based on two principals: shared-ownership and sustainable management of resources. The main business model of PT SOBI focuses on enhancing the capacity of smallholder-owned forests that are managed to strict sustainability standards. PT SOBI will act as a trading arm and manufacturer of wood-related products sourced from the smallholders. PT SOBI will also oversee the implementation of best-practices in forest management, group-certify the forest under its management, professionally manage the wood-related business, and consolidate the marketing effort of wood-related products, allowing the smallholder forest owners to earn a better living which then also impacts their families and communities.

To ensure the optimal implementation of PT SOBI's goals as both a social enterprise organised as a limited company, PT SOBI has a unique ownership structure that allows for collaboration between private investors and non-profit organizations. It combines commercial funding from the private sector and grants from the non-profit sector which can then be converted into cooperative ownership under SOBI management. As a result, PT SOBI expects to realize a sustainable impact as well as a balance between profit-making and realising its social mission. PT SOBI raises 40% of its required capital from private investors and 40% from NGOs or government funding which is then converted into cooperative ownership. The corporation status also enables PT SOBI to effectively carry out its role as trading arm and manufacturer with specific required licenses. The founder of PT SOBI envisions that its structure can create a new ideal model of corporation that is able to balance the business need of creating profit to fuel future growth with the social goal of developing a fair wealth distribution in society.

### THE UMBRELLA APPROACH: THE CASE OF YAYASAN CINTA ANAK BANGSA

YCAB is an Indonesian entity focused on youth development, which carries out holistic programs in which education and access to finance converge to enable sustainable economic independence. Initially established as a foundation, YCAB found it quite difficult to obtain sustainable revenue. They therefore evolved into a social enterprise hybrid structure, utilising a group of organisations to generate additional funding to cover administration expenses and operational costs, on top of the corporate partnership funding and public donations used for majority of its programs.

Their hybrid social enterprise structure consists of several business units such as (i) PT YADA Indonesia—a limited liability company (PT) which profits from its business selling animal rides for kids; (ii) Terrazone—a PT which establishes and operates game centers in malls and department stores in Indonesia; (iii) Koperasi YCAB or YCAB Cooperative which runs the education linked micro-loans operation focusing on underprivileged women entrepreneurs; (iv) Beauty Inc—a limited liability company focusing on health and beauty treatments; and, (v) FLIP—Human Resource consultant with a unique approach, emphasizing training and development by enabling organizations' sustainability and independence through academic learning and cultural and psychological understanding. Currently there are more than 655 staff members supporting the YCAB Social Enterprise Group.



## ALL IN THE FOUNDATION: DOMPET DHUAFA

Yayasan Dompot Dhuafa (DD) was established in 1994 as a charitable foundation focusing on economy, health, education and disaster relief. Since then, DD have evolved into a hybrid legal entity structure—in 2001, DD was legalized as National Zakat Management institution (Lembaga Amil Zakat Nasional) by the Department of Religion.

In 2016, DD established its social enterprise arm under Dompot Dhuafa Social Enterprise (DDSE) to answer the growing needs for DD to work directly with corporation partners and operate as a business – for example by providing hospital and health services, tourism and even construction. Through DDSE, DD can continue to serve its partners through professionally run business unit while providing more stable revenue stream to support operational needs for its Foundation charity programs. Until 2017, DDSE remains as a structure under DD Foundation – resulting to a growth amounting to IDR 97 billion at the end of 2016. Only by mid-2017, DDSE was separated from DD into an independent limited liability company. The profit and dividend gained from DDSE operation will be fully utilized to support programs on basic needs of below poverty community after being deducted with operational cost for the organization.

## EXPANDING ITS OUTREACH: THE CASE OF AMARTHA

PT Amarta Mikro Fintek (Amarta) has operated since 2010 as an online platform peer to peer (P2P) lending service for unbanked communities, connecting micro and small entrepreneurs with average capital needs of approximately IDR 3 million, with individual investors looking for attractive investment alternatives which provide a social impact. Amarta guarantee transparency and manage credit risk through a credit scoring system indicating on-time repayment and a success rate of return of each of its borrowers, and a joint liability (tanggung renteng) method.

Activities conducted by Amarta are regulated and overseen by the government under the financial technology industry regulatory framework; specifically POJK Number 77 concerning Implementation of Loans and Borrowing System with Information Technology Applications. Amarta was established in 2010 as a cooperative (Koperasi) micro finance institution. During its initial phase, Amarta's group lending operations were limited to the Bogor area, with members who were mostly mothers and other women. Amarta continued its operations for the next five years using this business model and managed to maintain a default rate of 0%. Following the growth of innovation and technology in financial sector, including for micro and small business, Amarta established PT Amarta Mikro Fintek to allow a larger outreach to investors and enable group lending all across Indonesia. The PT structure also allows Amarta to better explore technology-based risk management which increases the trust level for the platform. To date, Amarta have disbursed IDR 181.34 Billion, and empowered 62,953 micro entrepreneurs with a 99.61% on-time repayment rate.

## QUESTION AND ANSWER

**Is it possible to transform a charity/Non-Government Organization (“NGO”) registered in Indonesia to become a SE model?**

**Answer:** Yes, it is possible. However, the process does not involve a simple from NGO to SE. Rather, it will involve the establishment of a new SE and dissolution of the charity/NGO pursuant to the prevailing laws. The establishment and the dissolution are two separate processes.

In the above scenario, it is recommended that the establishment of the SE be processed prior to the dissolution of the NGO in order to allow such SE to receive the transfer of assets from the NGO prior to being dissolved. In this process, the NGO’s management must ensure that, after the transfer of assets to the new entity, the NGO still has sufficient funds to settle all of its outstanding payment obligations and to cover all costs related to its dissolution process.

**Using existing legal entity scheme, how do you ensure that SE characteristic is adhere to? What instrument can you use?**

**Answer:** The entity may ensure the implementation of SE’s values within its organization through the following means:

- (vii) adjusting its AOA to set out provisions relevant to the SE purpose. However, in adjusting the AOA, we recommend that the founders consult with the notary or legal advisor to ensure that the SE specific provisions do not violate any prevailing laws;
- (viii) inserting provisions in the AOA regarding the utilisation of net profit, such as of the amount of net profit that will be reserved for social activities and the amount of net profit that could be distributed as dividend to the shareholders/founders/members; and
- (ix) points (1) and (2) above may also regulated under an agreement between shareholders/founders/members (e.g., a shareholders agreement).

**What types of legal entity have more opportunities in participating on government tender/program?**

**Answer:** The types of entity that could participate in government tender will depend on (i) specific regulations applicable to tender, as applied by each governmental institution responsible for such tender and (ii) the type of work/goods/services that are requested by the government institution. PTs, partnerships, firms and CVs are commonly seen participating in government tenders.

**Any restriction of revenue stream to be obtained by foundation and/or any other legal entity?**

**Answer:** There are no specific regulations that restrict the revenue stream of a foundation and/or any other legal entity, provided that such revenue stream does not contravene their respective AOA and the prevailing laws.

**Any restriction of salary provision for legal entities (i.e., foundation, association, Company, etc.)?**

**Answer:** For a foundation, the members of the BOA and BOS are prohibited to receive salaries from the foundation. In a PT, the members of its BOD and BOC may or may not receive salaries, depending on the decision of the GMS. There are no specific regulations that prohibit a sole proprietorship, partnership, firm, CV, cooperative and association in paying salaries to the members of their respective management or supervisory boards.

**Can a foundation own a business entity? If yes, what is the requirement/limitation to the foundation in owning a business entity?**

**Answer:** Yes, a foundation may invest/participate in one or more business entities provided that the value of such investment/participation does not exceed 25% of the foundation's total asset value.

**Any risk associated for the foundation to have assets registered under its business entity?**

**Answer:** Even if a foundation establishes/owns shares in a business entity, such business entity will be considered as a separate entity. Therefore, all risks related to the assets of the business entities would not be associated with the foundation. This includes assets given by the foundation to the business entity as an in-kind contribution.

**Any separate legal requirements for fundraising and/or crowdfunding activities to obtain additional assets and/or support its operation?**

**Answer:** Pursuant to Law 9/1961, fundraising activities may be conducted only by a mass organization/association after obtaining a permit from the following authorities:

- (x) the Ministry of Social Affairs, for any fundraising activities that are conducted nationally or in more than 1 province, or if the fundraising is intended for offshore social activities; or
- (xi) the governor, for any fundraising activities conducted only within 1 province; or
- (xii) the Regent, for any fundraising activities conducted only within 1 regency.

Please note that the authorities may only grant the above permit if the applicant could prove that such fundraising will be used for the development of social welfare, mental/religion/spiritual or culture.

Currently, there is no specific regulation on crowdfunding. The Indonesian Financial Service Agency (*Otoritas Jasa Keuangan* or “**OJK**”) is currently working on the draft regulation on crowdfunding.

# LAO PEOPLE'S DEMOCRATIC REPUBLIC





# LAO PEOPLE'S DEMOCRATIC REPUBLIC

## INTRODUCTION

The Lao regulatory framework does not specifically address the feasibility of establishing a social enterprise, with the framework being simple and not yet sophisticated enough to officially allow any overlap of business activities and social mission under a single legal entity. However, Lao PDR has nothing to gain from strictly prohibiting such a development, which could pave the way for the social enterprise business in Lao PDR.

Indeed, the country experiences a lack of human resources, and poverty alleviation and human development remain the foremost objectives of the government of Lao People's Democratic Republic (Lao PDR). As such, social enterprises can help fill the void that currently exists in Lao PDR, reducing the burden on the government by offering incentives to companies that are willing to help alleviate poverty in remote areas by running a sustainable business within the country and sharing their prosperity and the fruits of their success with Lao nationals.

Although some companies and non-profit organizations operating in Lao PDR label themselves as social enterprises, there is currently no legal definition of a social enterprise in Lao PDR, and authorities are not aware of or fully familiar with this concept. There is no special regulatory framework for these entities, and social entrepreneurs must work to fit their ventures into the existing regulatory framework to accommodate their business objectives and social mission.

Although it is not easy, the Lao regulatory framework does provide some flexibility to fit the concept of a social enterprise and localize it from a Lao perspective. Various entities currently market themselves as social enterprises to promote their activities. These range from non-profit organizations to limited companies.

Types of investment and types of legal structures in Lao PDR are governed by the Law on Investment Promotion 2009 and the Law on Enterprises 2013, respectively. The Law on Investment Promotion sets out three types of investment in Lao PDR for business purposes:

1. Wholly foreign-owned or local investment;
2. Joint-venture investment, which involves the establishment/operation of a joint-venture business/entity between domestic and/or foreign investors; and
3. Business contracts by cooperation.

The Law on Enterprise makes the following legal structures available for the purpose of operating a business in Lao PDR:

- Representative office
  - Branch
  - Partnership
-

- Limited company
- Sole limited company
- Public company
- State-owned company

Few of the structures above are a 100 percent match for social enterprises.

Partnerships are rarely used in Lao PDR, and thus, there are few precedents available. The legal framework for setting up social enterprises in the form of partnerships may not prove to be as solid as those in place for limited companies.

A representative office is usually established primarily for market survey purposes, in order to collect information to consider further investments in Lao PDR in the near future, as stated under the Law on Investment.

Branch licenses are usually granted to certain types of businesses<sup>1</sup> such as: (1) airlines; (2) banks; (3) insurance companies; or (4) international consulting firms. Therefore, this structure may not be a viable option for a legal entity to run what would be seen as a social enterprise.

Among all of the mentioned legal structures, the limited company and sole limited company structures may be the most suitable for carrying out a social enterprise activity in Lao PDR. In fact, these two structures are the only types of business structures that have been chosen and used for the purpose of operating social enterprises in Lao PDR.

Aside from legal structures that are typically used for business purposes, non-profit organizations are also key players fueling the growth of social enterprises within the country. Indeed, many international non-governmental organizations (INGO) and non-profit associations (NPA) claim to be operating under a social enterprise concept.

There is another structure that is not yet popular in Lao PDR but may develop into an option to form a social enterprise. Lao PDR is encouraging public and private sector cooperation to collectively develop and build labor skills development centers.<sup>2</sup> Basically, this is a vocational center that is set up to provide training for people who have livelihood difficulties, or are searching for a professional vocation, in order to fill the market with skilled labor, as Lao PDR is suffering from a shortage of skilled workers. Although some of these centers have been operating for quite some time now, there is no proper law/decreed formalizing their existence. This type of entity will also be further discussed below.

In the next section, we will explore the various legal forms available to social enterprises in Lao PDR, and the implications associated with each structure. The legal structures for social enterprises in Lao PDR include:

- Private limited company
- NPA / INGO
- Labor skills development center

<sup>1</sup> Instructions on the Establishment of Business Branches in Lao P.D.R. No. 1641 dated September, 2014

<sup>2</sup> Article 4 Law on Labor 2013

## LEGAL STRUCTURE 1 – PRIVATE LIMITED COMPANY / SOLE LIMITED COMPANY

### a. Overview

A private limited company is the most common form of company in Lao PDR. The principles of this structure in Lao PDR do not differ very much from other jurisdictions. Save for very few provisions, private limited companies and sole limited companies are governed in the same manner by the Law on Enterprises.

Shareholders in a private limited company can be either individuals or legal entities. The Law on Enterprises sets out a list of rights to protect the rights and interests of shareholders.<sup>3</sup> Among other rights, shareholders can obtain and examine the records of the company, receive dividends from their shareholding in the company, file a complaint against the directors or any employee of the limited company if their interests are prejudiced, etc. Dividends in a private limited company are distributed upon approval from a shareholders' meeting. However, if the limited company sustains accumulated losses from the previous year, it may not distribute dividends. Whenever the company wishes to raise its capital, shares can be issued to private investors. This raising of funds cannot be made from the general public, which is in contrast to public-listed companies.

The articles of association (AOA) set out the internal organization/structure of the company. The AOA must include the following elements:

- Name of the company
- Business purpose
- Name and the location of the headquarters
- Capital, value and number of shares, the proportion contributed in kind/cash, and the number of common/preferred shares
- Names and contact details of the founders of the company
- Provisions referring to the liability of the director

The Ministry of Industry and Commerce (MOIC) provides a template of the AOA, in Lao language only, which can be modified. The investors can utilize the template to form a limited company, or add/implement additional details/chapters at a later date as needed.

Along with registered capital, there is a statutory reserve fund to which the company must contribute.<sup>4</sup> The statutory reserve fund secures against risks, wherein the limited company must convert 10 percent of its net profit into the reserve fund each year after deducting accumulated losses. When the reserve fund reaches half of the registered capital of the limited company, the limited company may suspend contribution of such funds, except if stated otherwise in the company's articles of association.

Although efforts have been made in recent years, several restrictions remain on foreign investors. These restrictions may differ depending on the activities that are carried out in Lao PDR, and for some of the activities, the authorities will require a foreign investor to partner with a local investor under a defined share ratio, which can also differ from one activity to another.

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<sup>3</sup> Article 104 Law on Enterprises 2013

<sup>4</sup> Article 156 Law on Enterprises 2013



Nonetheless, the minimum required registered capital for an entity wholly owned by a foreign investor is USD 125,000.<sup>5</sup> The activities to be conducted require approval by the MOIC and will appear on the enterprise registration certificate of the company. Any modification of these activities will have to be notified/approved by the MOIC.

## **b. Advantages & disadvantages**

### Advantages

- ✓ Can operate and conduct approved/authorized trading activities at will and collect fees from it without restrictions.
- ✓ Faster to establish than a non-profit organization, although it may require 3-6 months for a general business company to be established in Lao PDR.
- ✓ Limited liability for the shareholder(s).

### Disadvantages

- ✗ High minimum requirements for foreign investors (e.g., minimum registered capital is USD 125,000, which can increase depending on the contemplated activity).
- ✗ Restrictions on foreign investment.
- ✗ The original purpose of this legal structure is not suitable for social missions.
- ✗ Reporting and tax obligations.

## **c. Establishment process, documentation & costs**

Establishment can differ slightly depending on whether the company's contemplated activities are considered to be a general business or a concession-related activity. Concession activities usually involve businesses where special rights have to be negotiated with the government, and generally concern the following sectors: (1) mining; (2) energy; (3) exploitation of natural resources; and (4) telecommunications. We will therefore disregard the concession registration process for a company, as it does not involve the types of activities that are typically conducted by a social enterprise.

Applications to register a general business are submitted directly to the MOIC, or its provincial or local offices where the AOA and the business license will be issued. Some activities may require further approval from different ministries, and the MOIC will liaise with them before issuing the enterprise registration certificate.

<sup>5</sup> Article 17 Law on Investment Promotion 2009



The registration process, required documentation, and official fees are listed in the table below:

| Registration of a limited company                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Official fee (LAK)                | Time frame         |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|--------------------|
| <p>A person or juristic person who wishes to establish a company in Lao PDR will first need to submit an application, with the following details, to the MOIC:</p> <ul style="list-style-type: none"> <li>• Application to reserve the name of a limited company</li> <li>• Supporting documents</li> <li>• Specific form to be completed;</li> <li>• By law, a copy of the contract of incorporation is required, but in practice, the officer may not require such a contract; and</li> <li>• Power of attorney, if any (3 copies).</li> </ul>                                                                                                                                                                                                                                   | 10,000/set                        |                    |
| <ul style="list-style-type: none"> <li>• Application to register a limited company</li> <li>• Supporting documents</li> <li>• Specific form to be completed;</li> <li>• Contract of incorporation (3 copies);</li> <li>• Articles of association (3 copies);</li> <li>• Minutes on the establishment of a company for sole limited company and if the shareholder is a legal entity (3 copies);</li> <li>• Power of attorney for the assignee to undertake the registration, if any (3 copies);</li> <li>• For a foreigner, copies of the identification card or passport (3 copies);</li> <li>• Six photos (size 3x4 cm) which have been taken within the past three months;</li> <li>• Office location certificate; and</li> <li>• Curriculum vitae of the investors.</li> </ul> | 70,000/set                        |                    |
| <b>Official fees for issuing an enterprise registration certificate</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                                   |                    |
| The official fee depends on the company's registered capital.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | None                              |                    |
| Less than LAK 1,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 20,000                            |                    |
| LAK 1,000,001 to 10,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | 50,000                            |                    |
| LAK 10,000,001 to 20,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 100,000                           |                    |
| LAK 20,000,001 to 50,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 300,000                           |                    |
| LAK 50,000,001 to 100,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | 500,000                           |                    |
| LAK 100,000,001 to 400,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 1,000,000                         |                    |
| LAK 400,000,001 to 1,000,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 2,000,000                         |                    |
| LAK 1,000,000,001 to 10,000,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | 3,000,000                         |                    |
| LAK 10,000,000,001 to 20,000,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | 5,000,000                         |                    |
| More than LAK 20,000,000,000                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                                   |                    |
| <b>Certificate of approval from the Bank of Lao PDR to import capital</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                   |                    |
| Once the MOIC has issued the enterprise registration certificate, it is possible to obtain a registered capital certificate from the Bank of Lao PDR (BOL). The BOL will also approve said capital for the legal entity and its business purpose.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                   |                    |
| <b>Registration for tax identification</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | <b>Official fee</b>               | <b>Time frame</b>  |
| Once the enterprise registration has been delivered, the company will need to apply for a tax identification registration.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Depends on the registered capital | 30 working days    |
| <b>Company seal</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | <b>Official fee</b>               | <b>Time frame</b>  |
| <p>After passing the registration process, the applicant must bring the following set of documents issued by the MOIC to the Vientiane Public Security Bureau to apply for a company seal:</p> <ul style="list-style-type: none"> <li>• Application for a company seal (form will be filled in by the officer)</li> <li>• Supporting documents</li> <li>• Enterprise registration certificate;</li> <li>• Tax identification certificate; and</li> <li>• Letter of transfer from the MOIC.</li> </ul> <p>After receiving the company seal, the applicant is required to seek approval to use the seal from the Vientiane Public Security Bureau.</p>                                                                                                                               | 500,000                           | 10-15 working days |

| Company signboard                                                                                                                                                                                                                                                                                                                                                                                                                                           | Official fee   | Time frame         |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|--------------------|
| <p>In order to apply for a company signboard, the following documents are required to be submitted to the Ministry of Information Culture and Tourism.</p> <ul style="list-style-type: none"> <li>• Application for a company signboard</li> <li>• Supporting documents.</li> <li>• Enterprise registration certificate;</li> <li>• Tax identification certificate; and</li> <li>• Photo of the director.</li> </ul>                                        | 50,000         | 10-15 working days |
| Remark                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                |                    |
| <p>Apart from the fee for the application form, there are other official fees such as the measurement fee for the length of the signboard whereby 1 meter will cost LAK 100,000. The approval for the signboard is valid for one year, and it can be renewed. The renewal should be done before the expiry date.</p>                                                                                                                                        |                |                    |
| Employment contract registration                                                                                                                                                                                                                                                                                                                                                                                                                            | Official fee   | Time frame         |
| <p>The procedures for employment contract registration are as follows:<br/>           Collect the employment contract form from the Ministry of Labor and Social Welfare;<br/>           Fill in, amend, or add details to the form, without deleting the original;<br/>           Submit the form, along with the enterprise registration certificate and tax identification certificate, to the Ministry of Labor and Social Welfare for examination.</p> | 100,000        | 60 working days    |
| Social security fund                                                                                                                                                                                                                                                                                                                                                                                                                                        | Official fee   | Time frame         |
| <p>In order to apply for membership in the social security fund, the following documents are required:</p> <ul style="list-style-type: none"> <li>• Application for social security fund membership</li> <li>• Enterprise registration certificate;</li> <li>• Tax identification certificate; and</li> <li>• Map showing the company location.</li> </ul>                                                                                                  | Free of charge | 10 working days    |

A business plan is also usually required for the contemplated activities.

#### d. Liabilities

The company's shareholders are liable for the investment value of the shares they hold, but they are not liable for their own personal assets, unless they have previously provided a guarantee of their personal assets for the benefit of the company. Therefore, the general principle is that shareholder liability remains restricted to their investment, and they cannot be liable for the company's debts. The Law on Enterprises further provides that shareholders are only liable for the company's debts up to an amount not exceeding the unpaid portion of their shares.<sup>6</sup> As preferred shares are also recognized by the Law on Enterprises, shareholders within the same legal entity can have different rights.<sup>7</sup>

A director will be liable for:

- acting outside the scope of the limited company's business purposes as specified in its articles of association, or in the contract of incorporation;
- breaching the limited company's articles of association;
- exercising rights and performing duties beyond the assigned scope of power; and
- failing to exercise assigned rights or perform assigned duties.

In any of the events mentioned above, the limited company remains liable to third parties.

<sup>6</sup> Article 3 Law on Enterprises 2013

<sup>7</sup> Article 99 Law on Enterprises 2013

## e. Tax Treatment

The tax system in Lao PDR is not centralized, which can be cumbersome for some limited companies when they attempt to expand their business and open locations in other provinces. Tax obligations in different provinces have to be fulfilled with different officers, who may require some companies to provide protracted explanations to clarify their revenues. Lao law prescribes two types of taxes: direct and indirect.

### Direct tax<sup>8</sup>

#### Profit tax

Profit tax is collected on the profits of a company, regardless of whether it is a domestic or a foreign entity. The maximum rate of profit tax is 24 percent for both domestic and foreign legal entities.

| Annual profit base (in LAK)   | Taxable amount (LAK) | Rates      | Tax at each Level (LAK) | Total (LAK) |
|-------------------------------|----------------------|------------|-------------------------|-------------|
| Less than 3,600,000           | 3,600,000            | 0 percent  | 0                       | 0           |
| From 3,600,001 to 8,000,000   | 4,400,000            | 5 percent  | 220,000                 | 220,000     |
| From 8,000,001 to 15,000,000  | 7,000,000            | 10 percent | 700,000                 | 920,000     |
| From 15,000,001 to 25,000,000 | 10,000,000           | 15 percent | 1,500,000               | 2,420,000   |
| From 25,000,001 to 40,000,000 | 15,000,000           | 20 percent | 3,000,000               | 5,420,000   |
| More than 40,000,000          | .....                | 24 percent | .....                   | .....       |

#### Carried forward annual losses

Lao tax regulations recognize the procedure for carrying forward annual losses. In the event of losses within a year, such losses can be carried forward to be offset with profits for the following year within a three-year period, based on certification from the Audit Authority, or an independent audit company recognized by the Tax Administration. After completing the three-year period, the remaining losses are no longer allowed to be offset from the profit.

#### Income tax

Both local and foreign individuals are subject to income tax. Foreigners working in Lao PDR are liable to pay tax in Lao PDR, unless a specific agreement signed between Lao PDR and the relevant country of origin is applicable.

The income tax rate in Lao PDR is progressive and includes salaries, wages, extra allowances, overtime work, position allowances, career allowances, annual bonuses, meeting allowances for members of the board of a company, and other benefits received in cash or in kind. The progressive rate ranges from 0 percent to 24 percent, as shown below:

| Annual profit base (in LAK)   | Taxable amount (LAK) | Rates      | Tax at each level (LAK) | Total (LAK) |
|-------------------------------|----------------------|------------|-------------------------|-------------|
| Less than 1,000,000           | 1,000,000            | 0 percent  | 0                       | 0           |
| From 1,000,001 to 3,000,000   | 2,000,000            | 5 percent  | 100,000                 | 100,000     |
| From 3,000,001 to 6,000,000   | 3,000,000            | 10 percent | 300,000                 | 400,000     |
| From 6,000,001 to 12,000,000  | 6,000,000            | 12 percent | 720,000                 | 1,120,000   |
| From 12,000,001 to 24,000,000 | 12,000,000           | 15 percent | 1,800,000               | 2,920,000   |
| From 24,000,001 to 40,000,000 | 16,000,000           | 20 percent | 3,200,000               | 6,120,000   |
| More than 40,000,000          | --                   | 24 percent | --                      | --          |

<sup>8</sup> Law on Tax 2015 Chapter IV

### Environmental tax

This direct tax is levied on entities that cause pollution, and more broadly, endanger the environment. There are no definite rates, and no regulation has set out a mechanism for calculating this tax. Therefore, at present, this tax will most likely not be applicable to a social enterprise or other types of ventures.

### Stamp duty

There is no fixed rate for stamp duty. Document registration is governed under a special decree, and the rates differ depending on the type of document.

### Dividends

Dividends paid to individuals or legal entities based abroad are subject to 10 percent withholding tax.

### Indirect tax<sup>9</sup>

Indirect taxes basically comprise value-added tax and excise tax. The former is levied on goods for consumption and services at the rate of 10 percent, as prescribed under the Value-Added Tax Law. Excise tax is levied on specific products designated by the Law on Tax, such as alcohol, tobacco, cars, and certain types of food.

### Tax incentives

Tax incentives are available for promoted sectors, as described in the Law on Investment Promotion.<sup>10</sup> Incentives will depend on the type of activities to be conducted. Agriculture, industry, handicrafts, and services are designated as promoted sectors. A detailed list of these activities, as well as the level of promotion they receive, is provided in the Investment Promotion Decree.<sup>11</sup>

The greatest tax incentives are offered for promoted-sector investments in remote areas which have no economic infrastructure to facilitate investments (zone 1). Zones with a moderate level of economic infrastructure, and which are suitable for accommodating investments to some extent, are classified as zone 2, while zones with good infrastructure for supporting investments are classified as zone 3.

- In zone 1, level 1 investments are entitled to profit tax exemption for ten years; level 2 investments are entitled to profit tax exemption for six years; and level 3 investments are entitled to profit tax exemption for four years.
- In zone 2, level 1 investments are entitled to profit tax exemption for six years; level 2 investments are entitled to profit tax exemption for four years; and level 3 investments are entitled to profit tax exemption for two years.
- In zone 3, level 1 investments are entitled to profit tax exemption for four years; level 2 investments are entitled to profit tax exemption for two years; and level 3 investments are entitled to profit tax exemption for one year.

The zones correspond to the remoteness and difficulty of accessing such areas, which affects the need for investments to lift people out of poverty. Therefore, the government encourages private investors to establish businesses in these zones by providing tax incentives. This can be an option for social enterprises interested in starting their business in areas that are definitely in need of jobs and sustainable income.

<sup>9</sup> Law on Tax 2015 Chapter III

<sup>10</sup> Article 49 Law on Investment Promotion 2009

<sup>11</sup> Article 31 Decree on the Implementation of Law on Investment Promotion April 20, 2011

## f. Ongoing Governance and Regulatory Obligations

As explained above, every type of activity must be approved prior to commencing operation. Restrictions or prohibitions that are imposed on business operators will mainly depend on the nationality of the owner/shareholder(s).

Lao PDR also has regulations that reserve specific activities for Lao nationals, and require specific vetting and scrutinizing for registration applications submitted by foreigners, before they can be approved. As restrictions/prohibitions remain relatively high for foreigners in Lao PDR, foreign investors need to ensure that they fully understand the specific requirements for their business before they proceed further.

Companies must provide an annual business report containing the following information:<sup>12</sup>

- Total capital, registered capital, and number of issued shares that remain unpaid
- Types and number of shares issued and paid up
- Name, location, and type of business undertaken by other companies or subsidiaries in which the limited company holds shares, and the types and number of shares
- A report in which the director of the company informs the company of its direct or indirect involvement in transactions of the limited company that could benefit them, or about any increase or reduction of their shareholding in a limited company, or in the company's subsidiaries, within the accounting year
- Amount and value of remuneration paid to each director by the limited company

Any other matters set forth in the limited company's AOA

## g. Corporate structure

A limited company must have at least one director. The nationality of the director is not restricted, and he/she can be either a Lao national or a foreigner. The director may or may not be a shareholder of the limited company. A company may have several directors,<sup>13</sup> in which case the director who is authorized to bind/engage the company with third parties is called the general director. A board of directors may also be established if needed. Directors of a limited company are elected for a period of two years.

Limited companies are composed of at least two shareholders and up to 30 shareholders.

A sole limited company, as its name implies, is composed of a single shareholder, which may be a legal entity or an individual who may or may not be the director of the company. A general shareholders' meeting has to be summoned at least once per year. In the case of the arrival of a new shareholder within the shareholding structure of the company, existing shareholders have preemptive rights by law.

## h. Governance

There are no rules or specific regulations on a company's governance that would restrict people of different nationalities from becoming a member of the board. The composition of the board can, however, be defined within the company's AOA.

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<sup>12</sup> Article 162 Law on Enterprises 2013

### i. Finance & fundraising

Companies in Lao PDR are often family businesses, and the laws provide the possibility of relying on personal savings, or receiving funds from a circle of relatives. A limited company can raise capital by increasing the initial shares of the company. Private donations may be authorized, but not on a large scale and cannot represent a substantive income of the company.

Third parties may enter into the capital of a limited company, but it should be noted that private limited companies in Lao PDR cannot offer shares to the public, advertise share sales, or issue debt to the public. Authorities are very cautious about this matter, which has become a much-discussed issue in Lao PDR as many local companies have sold debt to people before winding-up the company with the funds they have accumulated.

A company can seek funds through a loan with a commercial bank. As such, a personal guarantee from a shareholder/director can be granted over a personal asset. Accordingly, the limited liability of the guarantor will be extended to cover the personal security interest granted to the commercial bank.

### j. Case study - Ma Té Sai

Ma Té Sai was founded as a limited company by Emi Weir and Clemence Pabion in 2010. Ma Té Sai is wholly-owned by foreign shareholders and has operated primarily in Luang Prabang for almost seven years. The company describes its primary objective as conducting business to spread and promote special handicrafts made by villages throughout Lao PDR. As such, the company operates and buys textile goods from villages and sells them mainly to tourists and hotels seeking authentic Laotian goods.

Although Ma Té Sai operates as a normal business, it does have a real social aspect to it. Ma Té Sai invests in the people in its supply chain by teaching women how to sew and weave, establishing agreements with village chiefs for certain quality goods, and buying goods produced by each village. In doing so, Ma Té Sai has increased the general income in many villages and elevated the quality standards of Lao textiles.

Ma Té Sai provides machines and training for women to use in producing textiles and does not prohibit them from using the tools to sell to other clients, although there is prior agreement to protect the company's intellectual property rights by refraining from using the company's designs in works for other clients.

Ma Té Sai's staff and suppliers are Lao people, many of whom have worked with the company for many years. The company also partners with institutions to help women who were the victims of human trafficking by providing them with livelihood skills.

As part of their overall strategy, the company aims to boost the Lao tourism market and increase demand for handicrafts, which will sustainably increase villagers' income and preserve Lao culture.

For more information, please visit [www.matesai.com/](http://www.matesai.com/)

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<sup>13</sup> Article 125 Law on Enterprises 2013

## LEGAL STRUCTURE 2 – NON-PROFIT ASSOCIATION (NPA) / INTERNATIONAL NON-GOVERNMENTAL ORGANIZATION (INGO)

### a. Overview

In Lao PDR, NPAs and INGOs do not fall under the same regulations. NPAs are governed by the Decree on Associations, dated April 29, 2009 (Decree on NPAs), and the Recommendations on the Implementation of the Decree on Associations, dated December 8, 2009 (NPA Recommendations), and are reserved for Lao nationals. In contrast, INGOs are regulated by the Decree on INGOs, dated January 8, 2010 (Decree on INGOs), and the Guidelines for the Implementation of the Decree on INGOs, dated February 17, 2015 (INGO Guidelines).

### NPA

Until 2009, only civil society institutions were permitted by the local government. These represented mass organizations attached to the administration. The Decree on NPAs sets out the legal framework and requirements for the establishment and operation of Lao NPAs, which are regulated by the Ministry of Home Affairs. To date, the NPA remains the most common vehicle for social activities in the voluntary sector. The Decree on NPAs was shortly followed by the NPA Recommendations, which provided further details and clarifications.

According to the Decree on NPAs, a NPA is an organization that is mandated to build solidarity and mutual assistance between members and extend assistance to society. It also protects the legitimate rights and interests of the association, its members, or the community, and participates in national construction and development, and poverty eradication.<sup>14</sup>

The Decree on NPAs expressly provides NPAs with the right to advertise their activities within the country, enabling them to become well known among a wide range of potential donors. Likewise, the Decree recognizes the rights for NPAs to carry out economic activities.<sup>15</sup> Depending on the activity the NPA intends to carry out, a relevant ministry will be responsible for approving the NPA's license. If economic activities are to be carried out, the profits derived from these activities must be reinvested in the NPA to allow it to pursue its objectives, as defined in its charter.

Depending on their size, NPAs will depend on regulatory authorities at different levels: national, provincial, or district/municipality. The process for registering an NPA is still relatively slow and complex and authorities currently do not easily grant a full license for NPAs. However, their appearance in the Lao legal framework marks a turnaround in the Lao government's attitude towards social enterprises.

### INGO

The process for establishing an INGO often takes longer than setting up an NPA. As an INGO is considered to be a foreign non-profit-seeking legal entity, there is more scrutiny from authorities on the foreign activities that the INGO seeks to conduct in Lao PDR, and thus more obligations need to be fulfilled.

The Decree on INGOs states that an INGO's objectives are to contribute to the development of the country, assist and provide humanitarian aid, and reduce poverty in Lao PDR.<sup>16</sup> The competent authority that regulates INGOs is the Department of International Organizations, Ministry of Foreign Affairs.

<sup>14</sup> Article 2 Decree on Associations dated April 29, 2009

<sup>15</sup> Article 18 Decree on Associations dated April 29, 2009

<sup>16</sup> Article 2 Decree on INGOs dated January 8, 2010

## b. Advantages & disadvantages

### Advantages

- ✓ Low establishment costs, especially for NPAs
- ✓ Can raise significant funds through donations
- ✓ Tax exemptions

### Disadvantages

- ✗ Foreigners cannot sit on the board of NPAs
- ✗ Lengthy establishment procedures
- ✗ Uncertainties regarding the registration process for INGOs, and no guarantee that INGOs will ever receive a license to operate in Lao PDR
- ✗ Not suitable for conducting trading/service activities or generating significant revenue from such activities due to possible restriction by authorities

## c. Establishment process, documentation & costs

### NPA

The establishment of an NPA appears straightforward in the Decree on NPAs. However, the process is lengthy in practice. Authorities require a founder to initiate the filing of the registration. To meet the eligibility requirements, the founder must be a Lao citizen and have full mental and physical capacity.

The founder will also need to designate a Mobilization Committee (MC) that meets the following requirements:

- The MC must have at least three members, all appointed by the founder.
- One of the members must have professional experience that is consistent with the activities of the association.
- A member may be a legal entity or an individual.

The authorities involved in the registration process may differ, depending on the activities to be performed by the NPA. For instance, should the NPA conduct trading activities, the Ministry/Department of Industry and Commerce will be the authority responsible for authorizing and providing a trading license.

The process for registering an application for an NPA<sup>17</sup> is as follows:

1. Notification of the selection of the MC's members by the founder to the competent governmental authority, depending on the level of the NPA.
2. Preparation and submission of an application to the competent authority by the MC.
3. Within 30 days from the receipt of the NPA's incorporation documentation, the registration authority will issue a temporary license, which will enable the procedure to proceed further to determine whether to approve or reject incorporation of the NPA.

<sup>17</sup> Article 12 Decree on Associations 2009



4. Upon receiving a temporary license, the MC prepares and carries out a statutory general assembly to circulate and present the temporary license, deliberate over the NPA's charter, elect the executive and supervision boards, and approve the NPA's work plan and the resolution of the statutory assembly.
5. The MC is dissolved by the election of the board.
6. The executive board must submit all the conclusions of the statutory assembly, the approved draft charter, the approved business plan and resolutions, and the names of the elected members of the executive and supervision board to the authority in charge of the application within 30 days of the date of the closing of the assembly.
7. The authority must approve or reject the draft charter within 60 days of receiving all the documents sent by the executive board.
8. The date of approval by the authority is considered to be the date of the formal and permanent incorporation of the NPA.

Required documents:<sup>18</sup>

- Application
- Draft charter in line with the government's strategies, laws, and regulations, including all required details
- Professional and educational background, proof of residency, and proof of no criminal record for each member of the MC
- Detailed list showing future ordinary members
- Lawful title or lease agreement of the association's office in Lao PDR

The timeframe set out above is prescribed in the Decree on NPAs and should be strictly adhered to. Many of the NPAs operating in Lao PDR had to wait a long time before finally receiving a temporary license, and had to wait even longer before receiving a permanent license.

## INGO

The process of setting up an INGO as a legal entity begins with seeking an operation permit. The operation permit enables the representatives of the INGO to apply for a work permit and a visa to conduct all the activities necessary to complete the establishment of the INGO. Representatives are allowed to consult and seek advice from authorities, and draft the memorandum of understanding (MOU) with respect to the project.

The application for the operation permit must include the following elements, which have to be sent to the Ministry of Foreign Affairs (MOFA):<sup>19</sup>

- Application letter from the headquarters of the INGO
- Certificate of legal status of the INGO in the country of origin (registration certificate)

<sup>18</sup>. Article 13 Decree on Associations 2009

<sup>19</sup>. Article 5 Guidelines for the Implementation of the Decree on INGOs dated February 17, 2015

- Statutes and financial statements
- Plans for socioeconomic development or poverty reduction in Lao PDR
- Copy of the statutes of the INGO
- Background of the INGO's activities

Secondly, the INGO must seek approval of the project from the Lao government, who will review it. Project approval is required to allow the INGO to recruit Lao citizens and foreigners to implement the approved project, as defined in the MOU, under the supervision of concerned authorities. The INGO must carry out any procedures necessary to set up the project office and to obtain the INGO's seal.

Documents required to apply for project approval:<sup>20</sup>

- Application letter from the INGO's headquarters addressed to the MOFA to request project implementation approval
- Proposed MOU, with a detailed development program which is in line with the political landscape of the country, including budget, organizational scheme, and operations
- Agreement letter from any relevant authorities
- Other relevant documents as deemed necessary

Afterwards, an express request to establish an office in Lao PDR will also be vetted by the authorities, along with the following requirements:

- Application letter
- Copy of the project approval
- Identification information for the office, and a notarized lease agreement explicitly allowing the use of the premises as an office

The scope of the activities to be performed by the project office encompasses the INGO's expected coordination with government agencies, as well as the management, monitoring, and implementation of the INGO's projects.

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<sup>20</sup>. Article 7 Decree on INGO

Finally, upon receipt of the project approval, the INGO, along with the ministries involved in the registration process, must prepare a ceremony for the signing of the MOU within 30 days, in order to commence project operations.

|                                             | Steps                                                                             | Competent authority                                                                    | Timeframe (working days)                                                               | Validity period                                                                                                                | Fees (LAK)         | Relevant laws                                                 |
|---------------------------------------------|-----------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------|---------------------------------------------------------------|
| <b>Step 1: Operation permit application</b> | <b>Operation permit</b>                                                           | Department of International Organizations (DIO), MOFA                                  | 60                                                                                     | One year (renewable)                                                                                                           | 150,000 per year   | A. 5.1 Decree No. 013/PM<br>A. 4.1 Guidelines No.1064/AE.OI.3 |
|                                             | After operation permit approved, work permit and visa for foreign representatives | Department of Skills Development and Employment (Ministry of Labor and Social Welfare) | <ul style="list-style-type: none"> <li>• Visa: 7</li> <li>• Work permit: 30</li> </ul> | <ul style="list-style-type: none"> <li>• Work Permit: One year (renewable)</li> <li>• B2 Visa: One year (renewable)</li> </ul> | 5,300,000 per year | A.14 of Decree on importing foreign workers                   |
| <b>Step 2: Project Approval</b>             | <b>Project approval</b>                                                           | DIO and all concerned ministries                                                       | 60 per evaluation                                                                      | Evaluation every year                                                                                                          |                    | A4.4 Guidelines No.1064/AE.OI.3                               |
|                                             | Implementation Management Committee (IMC)                                         | MOFA                                                                                   |                                                                                        |                                                                                                                                |                    |                                                               |
| <b>Step 3</b>                               | <b>Project office approval</b>                                                    | MOFA                                                                                   | 14                                                                                     | Based on the project                                                                                                           |                    | A.12 Decree No. 013/PM<br>A. 10 Guidelines No.1064/AE.OI.3    |
| <b>Step 4</b>                               | <b>Approval to recruit</b>                                                        | MOFA                                                                                   |                                                                                        |                                                                                                                                |                    | A. 11 Decree No. 013/PM<br>A. 14 Guidelines No.1064/AE.OI.3   |
| <b>Step 5</b>                               | <b>MOU signing ceremony</b>                                                       | MOFA along with concerned ministries                                                   |                                                                                        |                                                                                                                                |                    | 4 Guidelines No. 1064/AE.OI.3                                 |

#### d. Liabilities

An NPA/INGO is a legal entity which is distinct from its members. As such, the liability of the members of the NPA is limited, and creditors are not able to reach out to access the members' personal assets. If the organization is sued, the liability of members for debts or damage is limited.

#### e. Tax Treatment

Neither the Decree on NPAs nor the NPA Recommendations provide information about tax treatment, as they refer only to the Law on Tax, which does not provide specific provisions for NPAs or INGOs. NPAs are required to pay tax on salaries, i.e., income tax, of the employees they employ. They are not taxed on their activities or on the donations that they receive. There is no written rule on this, and different NPAs may be liable for different tax treatments; some NPAs are totally exempt from any kind of tax.

The Decree on INGOs provides exemptions for INGOs with respect to equipment and the tax on the vehicles to be used while conducting the INGO's activities. Aside from these exemptions, the tax obligations will be

stated in the MOU to be signed with the government entities. Therefore, the principle of freedom of contract will apply here, as there is no written rule about specific tax treatment. Therefore, INGOs may be exempt from taxes, but only if agreed upon in the MOU.<sup>21</sup>

#### **f. Ongoing Governance and Regulatory Obligations**

An annual report of the NPA's organization and activities and a financial report must be submitted to relevant authorities each year.

INGOs are subject to a more exhaustive reporting scheme and must submit a report every three months to the Local Secretariat on INGOs to report on project implementation progress. In addition, there is a review meeting every six months between the INGO and the implementing partners, which represent the ministries that were involved in the registration process of the INGO. Finally, the INGO Guidelines set out an annual, mid-term, and final project evaluation and assessment, which will involve the participation of the MOFA, along with relevant ministries.

In contrast to NPAs, INGOs are not expressly authorized to conduct economic activities as neither the Decree on INGOs nor the INGO Guidelines mention this matter. Therefore, any economic activities that may be conducted in Lao PDR have to be expressly stipulated within the MOU and approved by the authorities.

#### **g. Corporate structure**

The basic structure of an NPA is composed of the following:

1. an executive board with at least a president and a vice-president;
2. a supervision board; and
3. a secretary general.

For INGOs, the Decree on INGOs refers to a requirement to have a project director or a representative. Beyond this, there are no further obligations.

#### **h. Governance**

The Decree on NPAs provides information on the duties of the executive board, the supervision board, and the secretary general as follows:

- The executive board is elected by the association's assembly, leads all activities, and decides on the NPA's main affairs in the period between two sessions of the general assembly.
- The supervision board is elected by the executive board and assists in monitoring activities carried out by the NPA to ensure compliance with the NPA's charter and laws and regulations.
- The secretary general assists the president of the NPA, and he/she is appointed by the executive board.

The Decree sets out a minimum of 10 members to be able to create an NPA at the local level. However, the creation of an NPA with fewer members will not be automatically rejected but treated on a case-by-case basis.

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<sup>21</sup> Article 17.2.3 Decree on INGO January 8, 2010

Foreigners are not allowed to sit on the executive or supervision board. However, the Decree and its Recommendations do not preclude foreigners from sitting on other boards or committees that have been stipulated in the AOA. Therefore, the charter could implement an Advisory Board of experts to bring technical value to the NPA, and these experts could be foreigners. The difficulty would then be to seek authorization for visas and work permits for these foreigners, as these documents are not often granted when the request comes from an NPA.

There are no particular rules relating to the governance of an INGO, as these are prescribed in their MOU and will be approved or rejected by authorities on a case-by-cases basis.

### **i. Finance & fundraising**

The main sources of funds of an NPA are the membership fees collected from its members, the donations it may receive from local or foreign individuals or legal entities, and the income generated through economic activities.

Donations usually represent the largest portion of an NPA's funds, especially at the outset of operations. This explains why many self-proclaimed social enterprises operate as an NPA, given that relying on donations is essential for the sustainability of these entities. Funds and donations can originate from local or foreign individuals or entities.<sup>22</sup> The Decree on NPAs specifically provides for the possibility of receiving funds from a foreign source.

Members, staff, and executives can also contribute their personal assets or donate to the NPA.

The problems that NPAs usually encounter are related to the long process required to obtain a permanent license. Indeed, some of the most important donations usually originate from foreign official institutions from Europe or other locations abroad. Generally, these institutions require a permanent license identification certificate, and thus NPAs with a temporary license are not eligible to receive such funds, which could have otherwise greatly helped them conduct their activities and facilitate the implementation of their social project in Lao PDR.

For INGOs, there are no provisions that expressly allow INGOs to conduct economic activities that would help raise funds for their contemplated social mission. Indeed, the Decree on INGOs and the INGO Guidelines only state that INGOs provide "development assistance and humanitarian aid, without any pursuit of profit."<sup>23</sup> However, there is no statement that would preclude an INGO from negotiating, in its MOU, types of activities that may be used to raise funds or collect fees to support its social mission.<sup>24</sup>

### **j. Case study – Fair Trade Lao PDR**

Fair Trade Lao PDR has been operating in Lao PDR since 2008 and was established as an NPA. The business aspect of this social enterprise is in promoting socially and economically sustainable fair trade, specifically helping farmers grow and sell high-quality local produce to customers.

The social aspect of Fair Trade Laos is in improving living conditions for the poorest people in La by entwining the country's economic growth objectives with efforts to improve social and environmental standards. To

<sup>22</sup> Article 44 Decree on NPA 29 April, 2009

<sup>23</sup> Article 2 Decree on INGO January 8, 2010

<sup>24</sup> Article 17.2; 17.5 Decree on INGO January 8, 2010

achieve the social aspect of its social enterprise, Fair Trade Laos serves as a certification body which provides qualified members with a certificate to show that they abide by minimum corporate social responsibility standards and are committed towards socially and environmentally responsible business practices.

Fair Trade Lao PDR models its certification standards on international organizations. However, as these standards are still too high for Lao PDR, they have tried to localize them to the Lao context, in addition to providing assistance and guidelines for meeting localized and international standards. Fair Trade Lao PDR also provides consultancy services for their members on product marketing, market surveys, and product development.

This NPA conducts and organizes events to raise awareness among business operators and the public. They also work closely with the government to promote better understanding of the necessity of fair trade and good social and environmental conditions in Lao PDR.

Operating under an NPA structure is a natural solution for Fair Trade Lao PDR, enabling them to conduct their activities in a financially sustainable environment. Although they collect fees from members for their consultancy services, fundraising from the public or official institutions remain their main source of income.

For more information, please visit <http://www.laosfairtrade.org/>

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## LEGAL STRUCTURE 3 – LABOR SKILLS DEVELOPMENT CENTER

### a. Overview

This type of structure remains relatively unexplored in Lao PDR, as there are only a few labor skills development centers to be found in the country. Under this structure, it is possible to operate any activity, provided it also carries out its objective of training people to upgrade their livelihood skills or teach them new skills. A reference to labor skills development centers can be found in the Labor Law. The main ministry in charge of the establishment of these centers is the Ministry of Labor and Social Welfare.

The formation and operation of such centers are expressly provided for under the Labor Law. However, there is no information about the specific requirements or the establishment process for such a legal entity under the law. To ascertain the requirements, it is necessary to request information from the Ministry of Labor and Social Welfare.

Nevertheless, the state expressly supports and promotes the creation of such labor skills development centers, and openly encourages state-owned companies, as well as the private sector, to conduct skill development activities. The state encourages people, legal entities, and organizations to build skills development centers and form recruitment service networks, in order to contribute to the development of skills and recruitment which will help to strengthen and upgrade the Lao workforce, making it more competitive regionally and internationally. Therefore, the objectives of these centers are to: (1) develop and nurture skilled workers; and (2) provide the Lao market with skilled workers.

At present, officers from the Ministry of Labor and Social Welfare base rules and regulations for labor skills development centers on a legal draft that has not been made publicly available, and therefore it is hard to provide detailed information, although officers freely provide such information upon request from an interested investor. The operational mode of this legal structure is relatively similar to a limited company. The registered minimum capital is the same as the capital required for a foreign-owned limited company, which is USD 125,000. As such, foreigners are entitled to invest in, and assume 100 percent ownership of, this type of structure. Similar to limited companies, there is no threshold in terms of how much profit a labor skills development center can make

### b. Advantages & disadvantages

#### Advantages

- ✓ Authorization to officially operate a business activity along with a social mission;
- ✓ Eligible for donations from local and foreign donors;
- ✓ Faster to establish and set up than NPAs/INGOs; and
- ✓ Limited liability of the shareholders and staff.

#### Disadvantages

- ✗ Authorization to set up such entity is valid for only three years, after which renewal will be necessary;
- ✗ No particular tax incentives are automatically granted;
- ✗ No clear legal framework and few precedents are to be found—legal uncertainties remain;
- ✗ Difficulty in foreseeing incentives that the company may be eligible for; and
- ✗ The social mission of this structure is imposed and consists of providing training to people.

### c. Establishment process, documentation & costs

The Ministry of Labor and Social Welfare provides, upon formal request, a list of the necessary documents to file a registration application for the establishment of a labor skills development center. According to the requirements set out by the ministry, investors who wish to set up such a structure are required to submit the following information/documents:

- Specific form to be filled in for the establishment of the labor skills development center;
- Curriculum vitae of the applicant;
- Shareholders agreement;
- Certificate or evidence of education in relation to the contemplated center's activity;
- Copy of the identification card or family book for a Lao citizen, or a passport for a foreigner;
- Certificate of the investor's financial statements and assets; and
- Photo (size 3x4 cm).

A number of other documents related to the project will also have to be submitted:

- Business plan;
- Safety standards of the building structure of the center;
- Curriculum;
- Plan regarding the needs of employees and instructors;
- Plan regarding the needs of students or trainees;
- Budget plan (charges, expenses, and profit);
- Detailed plan relating to required equipment and materials;
- Detailed plan concerning fees, if any, to be collected from the students/trainees;
- Structure of the center, including detailed organization chart; and
- Details of the executive board of the center, and the following documents of each member: (1) proof of education; (2) proof of expertise in the contemplated activity; (3) identification or family book for Lao citizens, or a passport for foreigners. If no board is established, the details of the director may be submitted.

The license for a labor skills development center is only granted for three years and will need to be renewed if the center wishes to continue its operation. To date, every renewal request has been approved.

The official timeframe specified by the Ministry of Labor and Social Welfare from the submission of an applicant's registration documents until the delivery of the license is two months. However, this timeframe may not reflect the reality of the actual process, and it would be wise to plan for 3-6 months. In addition, authorities may also wish to inspect the premises of the training center beforehand.

### d. Liabilities

With regard to liabilities, the concept of this legal structure is similar to a private limited company. Every shareholder remains liable for their portion of the investment. Creditors will not be able to reach out to access the shareholders' personal assets. For more details, please refer to the section on limited companies.



**e. Tax Treatment**

The tax treatment in general is the same as that of the private limited company. Therefore, please refer to the section dedicated to private limited companies.

**f. Ongoing Governance and Regulatory Obligations**

There are no restrictions in terms of activities. The labor skills development center will be treated in a similar manner to a private limited company. As such, it will incur the same types of restrictions, which will, for example, depend on the nationality of the investors.

There is a reporting obligation that is specific to this type of legal structure. As these centers are established to provide the market with skilled labor, monitoring will be carried out by the Ministry of Labor and Social Welfare to assess the quality of training and employment statistics for the center's graduates. This type of training assessment will be made every six months or one year.

**g. Corporate structure**

This is similar to a private limited company.

**h. Governance**

This is similar to a private limited company.

**i. Finance & fundraising**

There is a noticeable advantage for a labor skills development center when compared to a limited company. The center is entitled to raise funds through donations from the public at large, either from local or foreign donors, while being able to conduct any business activities.

**j. Case study (fictional) - Lao PDR Beautiful Textiles - Labor Skills Development Center**

Lao PDR Beautiful Textiles has been established for a certain time by way of a joint venture, and it involves investors from different sectors and a Lao local partner, who holds minority shares. There is no board, with only a single foreign director in charge of the daily business of the center. The company's objectives are to promote and export Lao textile handicrafts by penetrating markets that have high demand for authentic goods. Therefore, Beautiful Lao PDR Textiles produces and exports products, monitoring each aspect of its business until the products enter the market. However, the company also officially supports and aims to enhance the skills of local people, by providing training for people in difficulties, so they have the opportunity to acquire unique skills in weaving and tailoring, and earn a livelihood. These people include homeless children, men and women from rural areas, and other underprivileged groups.

Lao PDR Beautiful Textile raises funds through the sale of their goods internationally, and also through donations received from both local and foreign donors. They regularly perform and advertise about donation campaigns. The organization intends to develop itself, improve the machinery used, and employ more instructors to provide improved teaching and training for local people, all of which also helps respond to the growing demands for their goods.

By providing opportunities for underprivileged people to acquire skills, Lao PDR Beautiful Textile has contributed to livelihood improvement for numerous people and their families, in addition to promoting and encouraging demand for Lao textiles worldwide.

## LEGAL STRUCTURE 4 – HYBRID / MULTIPLE STRUCTURES

### a. Overview

Hybrid or multiple structures are sometimes pursued for two reasons. As stated in this chapter's introduction, the overlap between a business activity and a social mission is not yet officially recognized in Lao PDR. Most established NPAs/INGOs limit their business activities only to their members, as they fear they would otherwise be deemed a business structure. This restricts the possibility of collecting fees for their goods or services from many potential clients, and imposes a serious financial constraint when a social enterprise wishes to diversify its sources of income. Operating through a limited company that is legally permitted to offer goods or services for sale would alleviate this financial constraint for an NPA/INGO, and would help them gain an alternative source of income rather than relying only on donations.

Likewise, a limited company that has a social mission may find it difficult to rely solely on business activities to cover costs and provide revenue for the company, while allocating sufficient funds for its social mission, especially at the outset of its business. Operating through an NPA/INGO would allow a limited company to accept donations as an alternative source of income.

This is why some social enterprises have decided to split their structures into two separate legal entities, enabling them to enjoy the benefits of both a non-profit organization and a limited company. The non-profit organization raises fund through donations and membership fees from its members, and the limited company raises funds from its business activities which can later be transferred for the social mission of the non-profit.

### b. Case study - Sustainable Agriculture & Environment Development Association (SAEDA) / Lao Organic Promotion in Agriculture Co., Ltd. (LOPA)

These two legal structures are an example of a hybrid/multiple structure working in tandem to fulfill their business and social objectives.

SAEDA is an NPA, and can therefore pursue its non-profit objectives of improving food safety standards and developing an environmentally friendly form of agriculture to enable sustainable economic development for Lao farmers.

Their activities include: (1) spreading sustainable agricultural practices and raising awareness about the use of appropriate technologies to improve productivity and farmers' yields, while also taking into account environmental issues; (2) developing the capacity of farmers and relevant authorities, by teaching them how to reach out to local, national and international markets, and raising their standards accordingly; (3) developing a farmer-to-farmer extension approach, in order to transfer good practices in the farming community and amongst key stakeholders; and (4) developing and increasing the skills of farmers so they use appropriate tools, as well as enabling them to access relevant information to conduct agriculture in a more sustainable way.

Although it is the business arm of SAEDA, LOPA adopts a similar vision with its aims to promote more sustainable economic development for Lao farmers, by introducing agricultural methods that are based on quality and environmentally friendly products. LOPA's services include: (1) providing training and workshops for interested parties; (2) building and advising on the best business model and business plan for local farmers; (4) anticipating problems that farmers may encounter in their agricultural business; and (5) developing and helping to market the farmers' products.

LOPA's income is derived from forming partnerships with local and international partners, and from providing the services described above. LOPA also receives income from the sale of products that are produced as a result of such sustainable and organic agricultural practices, as well as from sales of non-timber forest products, and publishing. Eventually, the profits that originate from the business services delivered by LOPA are partly used to help SAEDA in its social mission

For more information, please visit [saedalao.wordpress.com](http://saedalao.wordpress.com)

## TRANSITIONING BETWEEN LEGAL FORMS

**There is no official legal form for a social enterprise in Lao PDR. Therefore, transitioning between legal forms is not yet possible. Transition from an NPA/INGO into a business structure may be possible, but would entail a long process, which would first involve termination of the NPA/INGO before forming a limited company or labor skills development center. The Lao regulatory framework currently has no measures that would facilitate such a transition, nor is there a framework to support transitioning from a company limited to an NGO/NPA.**

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# MALAYSIA



# MALAYSIA

## INTRODUCTION

As one of the most economically developed countries in Southeast Asia, and the second easiest country in the region in which to do business (according to the World Bank's 2017 Ease of Doing Business Index), the spirit of capitalist enterprise holds a very favorable position in Malaysia. In addition, Malaysia consistently performs well in the CAF World Giving Index and has a strong and pervasive charitable imperative running through the myriad cultures that make up this global melting pot of a nation.

It is perhaps no surprise then that social enterprise—with its mix of humanitarian ethics and capitalist sustainability and adaptability—has been extremely popular since it rose to prominent in the late 1990s and early 2000s. Their popularity continues to increase, particularly among the younger generation, and the government are keen to encourage them, offering a range of incentives and support.

The Malaysian legal system, much like the British legal system with which it shares its roots, is very amenable to enterprise and allows for a great deal of flexibility in the creation and operation of any kind of business. However, for better or for worse there are no specific legal structures for social enterprises in Malaysia, and the legal system, though agreeable to use, can be tricky to navigate for the uninitiated.

**THIS GUIDE THEREFORE SETS OUT THE DIFFERENT LEGAL STRUCTURES FOR ANY FORM OF BUSINESS ENTERPRISE, THEIR PRACTICAL USE FOR SOCIAL ENTERPRISES, AND THE MERITS AND DEMERITS OF EACH.**

## LEGAL STRUCTURE 1 – LIMITED LIABILITY PARTNERSHIP (“LLP”)

### a. Overview

LLPs are regulated under the Limited Liability Partnerships Act 2012 (“LLP Act 2012”) which combines the characteristics of a company and a conventional partnership. The LLP business structure is designed for all lawful business purposes with a view to making profit. LLPs are often formed by professionals such as lawyers, chartered accountants and company secretaries for the purpose of carrying on their professional practice.

### b. Advantages & disadvantages

Advantages

- ✓ Separate legal entity
- ✓ Limited liability
- ✓ Cost saving as there is no audit requirement and less statutory compliances
- ✓ No limit to the number of partners (minimum requirement of two partners)
- ✓ No minimum capital requirement
- ✓ Flexibility in terms of its formation, maintenance and termination
- ✓ Capable of suing and being sued in its own name

#### Disadvantages

- ✗ Lack of awareness of LLPs which will impact the branding of the business. Most official forms (bank forms, online portals etc.) do not cater for LLPs and are unable to support LLP registration numbers.
- ✗ Lower credit ratings. LLPs are not required to have annual statutory audits and therefore have difficulties in obtaining credit from vendors; especially large corporations.
- ✗ Specific incentives provided to a company do not apply to a LLP.
- ✗ Most of the guidelines issued by government agencies such as business license application, immigration procedures generally focus on private companies.

### c. Establishment process, documentation & costs

An application to incorporate an LLP is to be made to the Registrar, and shall include the following particulars:

- name of the LLP;
- nature of business of the LLP;
- registered office of the LLP;
- name and details of every person who is to be a partner of the LLP;
- name and details of compliance officer(s) of the LLP;
- if the LLP is formed for the purposes of carrying on a professional practice, the application shall be accompanied by an approval letter from the relevant governing body; and
- such other relevant information as may be specified by the Registrar.

An LLP has to be registered online at <https://myllp.com.my>. A compliance officer of the LLP must be registered as the user of the MyLLP portal. The registration fee for a new LLP (or conversion to an LLP) is RM500.00.

### d. Liabilities

LLPs benefit from limited liability, meaning that the partners are not personally liable for the debts and obligations of the LLP. An LLP is also capable of suing and being sued in its own name, holding assets in its own name and other legal actions reserved for legal entities.

### e. Tax Treatment



LLPs are not assessable entities for tax purposes and profits are treated as part of each partner's personal income. Accordingly, LLPs do not enjoy the corporate tax benefits which are normally available to limited liability companies.

The taxation of an LLP with a total capital contribution (whether in cash or in kind) of RM2.5 million or less at the beginning of the accounting period shall be at the rate of (i) 19% for the first RM 500,000 and (ii) 24% thereafter.

The above rate does not apply to an LLP if more than:

1. 50% of the capital contribution (whether in cash or in kind) of the LLP is directly or indirectly contributed by a company;
2. 50% of the paid-up capital in respect of ordinary shares of the company is directly or indirectly owned by the LLP; or
3. 50% of the capital contribution (whether in cash or in kind) of the LLP and 50% of the paid-up capital in respect of ordinary shares of the company is directly or indirectly owned by another company.

Companies under paragraphs (1) and (2) above must have paid-up ordinary share capital of more than RM2.5 million at the beginning of the accounting period.

An LLP with a total capital contribution of more than RM2.5 million shall be taxed at the rate of 24%.

#### **f. Ongoing Governance and Regulatory Obligations**

Every LLP must comply with the following requirements of the LLP Act 2012:

1. Registration of changes in particulars  
An LLP must notify the Registrar of LLPs of any changes to its registered particulars within 14 days.
2. Annual declaration  
An LLP must lodge annual declarations with the Registrar of LLPs, signed by any two of its partners, stating whether the LLP is able or not able to pay its debts as they become due in the normal course of business. The declaration shall be accompanied by such other particulars as may be required by the Registrar, and must be lodged within 90 days of the end of the financial year.
3. Accounts to be kept  
An LLP must keep accounting and other records to sufficiently explain the transactions and financial position of the LLP and enable profit and loss accounts and prepare balance sheets from time to time which give a true and fair view of the state of affairs of the LLP at the LLP registered office, or such other place as the partner thinks fit provided that the Registrar of LLPs

has been notified. An LLP must also keep its records for a period of at least seven years from the end of financial year in which the transactions or operations to which those records relate are completed.

#### **g. Corporate structure**

Any two or more legal persons – whether individuals or other legal entities such as incorporated businesses – may form an LLP under an LLP agreement.

Generally, the LLP agreement governs the mutual rights and duties of both the LLP and its partners except as otherwise provided by the LLP Act 2012. The second schedule of LLP Act 2012 sets out certain default provisions for limited liability partnerships, including, amongst others, that no person may be introduced as a partner without the consent of all existing partners and every partner may take part in the management of the LLP.

#### **h. Governance**

An LLP may carry on business with fewer than two partners for a period not exceeding six months, or a longer period as may be determined by the Registrar of LLPs, provided that the extended period does not exceed one year. If a LLP carries on business with fewer than two partners longer than the foregoing period, the person shall be personally liable, jointly and severally with the LLP for any obligation of the LLP incurred during such period.

#### **i. Finance & fundraising**

Capital contribution by each partners may be provided in the LLP Agreement.

#### **j. Resources**

- Limited Liability Partnerships Act 2012
  - [www.mymagic.my](http://www.mymagic.my)
  - <http://www.ssm.com.my/en/LLP-AboutLLP>
-



- <https://myllp.com.my>

## LEGAL STRUCTURE 2 – SOLE PROPRIETORSHIP

### a. Overview

A Sole Proprietorship (“SP”) is regulated under the Registration of Business Act 1956 (“RBA 1956”). A SP is the simplest business structure wholly owned by one individual and must be registered with the Registrar of Business under the RBA 1956.

### b. Advantages & disadvantages

#### Advantages

- ✓ Simple administration
- ✓ Full control of all business decisions
- ✓ Easy to form and dissolve with minimum formalities
- ✓ All profits will go to the proprietor
- ✓ Lower compliance requirements
- ✓ Not required to disclose financial statements to public

#### Disadvantages

- ✗ Limited source of capital as it is based on the proprietor’s own contribution
- ✗ The owner may be held personally liable for the business’ debts
- ✗ Development of the business is limited to the capability of the proprietor
- ✗ The business will cease operations immediately once the proprietor is deceased

### c. Establishment process, documentation & costs

A SP may be registered using a personal name or a trade name. Where the business name is a personal name as stated on the proprietor’s identity card, approval of the name will not be required. On the other hand, where a business name uses a trade name, prior approval from the Registrar of Business must be sought. The registered name cannot be changed.

Registration can be done at the Companies Commission of Malaysia (“CCM”) or online at [ezbiz.ssm.com.my](http://ezbiz.ssm.com.my). The business must be registered no later than 30 days from the date of commencement of business. A SP registration application must be submitted by its proprietor, and must include the following particulars:

- business name;
- commencement date of business;
- principal place of business;
- information of owner; and

- type of business to be carried out.

The registration fee of SP varies depending on the business name, i.e. RM30.00 for personal name as stated in the identity card and RM60.00 for trade name. Generally, the business registration certificate can be obtained on the same day and shall expire on the date stated in the business registration certificate or upon termination of the business.

#### **d. Liabilities**

A SP will not enjoy separate legal entity and therefore are exposed to unlimited liability. The proprietor will be personally liable for all the profits and losses the business incurs. In the event, the business fails and liabilities remains unsettled, any of the proprietor's personal assets will be taken to settle all liabilities incurred by the business.

#### **e. Tax Treatment**

The rate of taxation of a SP ranges from 0% to 28% depending on the amount of income.

#### **f. Ongoing Governance and Regulatory Obligations**

One of the main advantages of being a SP is that there is less administrative requirements. For instance, a SP is not required to file annual return or annual accounts. Notwithstanding so, a SP must comply with the requirements under the RBA 1956 which includes amongst others, the following:

- **Changes in registered particulars**  
Whenever a change is made in any of the particulars registered in respect of the business, the person responsible for the business shall, within 30 days after the change is made, submit to the Registrar of Businesses in the prescribed form the particulars of the change.
- **Termination of business**  
Where a registered business has been terminated, the person responsible shall within 30 days of the termination notify the Registrar of Businesses in the prescribed form of such termination.
- **Display of certificate of registration**  
The certificate of registration issued in respect of a business registered shall be kept exhibited in a conspicuous place at the principal place of business.
- **Corporate structure**  
A SP is not treated as a separate legal entity, and there is no legal distinction between the proprietor and the business. As a result, entry into contracts and borrowings must be made in the name of the SP instead of a corporate entity.

#### **g. Governance**

The proprietor must be a Malaysian citizen or permanent resident of Malaysia, aged 18 years and above. Only the proprietor is allowed to make an application.

#### **h. Finance & fundraising**

Generally, a SP is funded by personal savings or private borrowings. SPs may also seek funding through loans from banks. However, it is more difficult for a SP to borrow money and obtain investment in their business due to the inability to allocate share capital.

#### **i. Case study**

1L Carwash is a social enterprise that aims to reduce water wastage and preserve the environment. Every carwash uses only one litre of water instead of the 189 litres used on average by a standard car wash.

Being structured as a sole proprietorship raises a number of difficulties for 1L Carwash, include reluctance by other companies to work with them due to the disparity in regulatory requirements, the need for extra caution due to unlimited liability for damage incurred by cars, the inability to offer income tax deduction receipts to potential CSR funders, and higher taxes compared to some other structures due to the income tax rates for individuals.

#### **j. Resources**

- Registration of Businesses Act 1956
  - Guidelines for New Business Registration issued by CCM
  - Guidelines for Business Name Application issued by CCM
  - [www.mymagic.my](http://www.mymagic.my)
-

- <http://www.ssm.com.my/en/sole/starting-a-sole-proprietorship-partnership>

## LEGAL STRUCTURE 3 – PARTNERSHIP

### a. Overview

A partnership is regulated by the Partnership Act 1961 (“PA 1961”) and is a business owned by two or more persons but not exceeding 20 persons. Like a SP, a partnership business must be registered with the Registrar of Business under the RBA 1956.

### b. Advantages & disadvantages

#### Advantages

- ✓ Easy to set up with few formalities
- ✓ Easier to secure financial assistance from financial institutions compared with sole proprietorship
- ✓ Equity can be increased through enlisting additional partners
- ✓ Business risks can be reduced and distributed among partners
- ✓ The responsibilities of managing and handling the business can be divided equally among partners

#### Disadvantages

- ✗ Partners may be held personally liable for the debts of the partnership
- ✗ The lifespan of the partnership business depends on the lifespans of the partners. If any of the partners passes away or is declared bankrupt, the business is automatically dissolved, unless there is an agreement otherwise.
- ✗ Profits must be shared with other partners.
- ✗ Disagreements may occur between partners.
- ✗ Joint Responsibility. Acts done by one partner within a partnership are the responsibility of all partners.

### c. Establishment process, documentation & costs

The establishment process of a partnership is similar to a SP as indicated in this Guide with the exception of the following:

- Only a trade name can be used as the business name, i.e. personal names such as that found in a partner’s identity card cannot be used; and
- The registration fee of a partnership is RM60.

### d. Liabilities

Partnerships have unlimited liability and the partners are jointly and severally liable for all debts and

obligations of the business. Hence, the partners are responsible for paying off all of the partnership debts personally if the partnership cannot make its payments. In the event one of the partners cannot pay the debts, the remaining partners may be called upon to settle the outstanding debts.

#### **e. Tax Treatment**

Each partner is taxed individually based on their shares in the partnership. The income tax charged depends on the amount of income of each partner which ranges from 0% to 28%.

#### **f. Ongoing Governance and Regulatory Obligations**

The ongoing governance and regulatory obligations are similar to those of a SP. The partnership may be dissolved after the expiration of a fixed term, death of partner or pursuant to a court order.

#### **g. Corporate structure**

A partnership is an enterprise in which more than one person is involved with a common view of profit. Generally, partners will formulate an agreement when forming a partnership in order to regulate the conduct and affairs of the partnership.

Partners are at liberty to fix the duration of the partnership. In the event no fixed term has been agreed upon for the duration of the partnership, any partner may terminate the partnership at any time by giving notice of his intention to do so to all the other partners.

#### **h. Governance**

The PA 1961 allows for not more than 20 persons to set up a partnership (save and except for partnerships for professional practice).

#### **i. Finance & fundraising**

- Personal savings

One of the primary sources for funding a partnership is the individual savings of each partner. Depending on the partnership agreement, equal partners may contribute an equal amount of their personal funds into starting and running the business. The partnership agreement could expressly provide for each partner to be responsible up to a specific amount or for a percentage.

- Small business loans

A partnership may also approach a bank or other financial institution to apply for a small business loan.

- Additional Partners

For existing partnerships looking to grow or expand the business, another source of funding may be to bring in additional partners into the business.

#### **j. Resources**

- Registration of Businesses Act 1956
  - Partnership Act 1961
-

- [www.mymagic.my](http://www.mymagic.my)
- <http://www.ssm.com.my/en/sole/starting-a-sole-proprietorship-partnership>

## LEGAL STRUCTURE 4 – TRUSTS

### a. Overview

A trust is a legal arrangement in which ownership of assets is transferred from the person who set up the trust to another person or corporation (trustee) for the benefit of one or more people (beneficiaries). The beneficiary of a trust holds an equitable interest in the asset even though the trustee has legal ownership, meaning that the trustee can only exercise its legal rights over an asset for the benefit of the beneficiaries.

The operation of a trust is governed by the Trustees (Incorporation) Act 1952 and Trustees (Incorporation) (Amendment) Act 2004 (collectively, the “TIA”) which apply to Peninsular Malaysia only.

### b. Advantages & disadvantages

#### Advantages

- ✓ Structure provides confidentiality.
- ✓ Avoid probate.
- ✓ Continuity of management during disability.
- ✓ Protection and preservation of assets.

#### Disadvantages

- ✗ Complexity of structure.
- ✗ Administrative costs may be high.
- ✗ Registration of assets in the name of the trust.

### c. Establishment process, documentation & costs

Trustees or a trustee may be appointed by any person or association of persons established for any religious, educational, literary, scientific, social or charitable purpose. An application to register a trust must be made in writing to the Minister in the Legal Affairs Division of Prime Minister Department (the “Minister”). The application must be signed by applicants and must contain, amongst others:

1. the objects of the body or association of persons, and the rules and regulations of the same, together with the date of, and parties to every deed, will or other instrument, if any, creating, constituting or regulating the same;
2. a statement and short description of the land, or interest in land, which at the date of application is possessed by, or belonging to, or held on behalf of such body or association of persons; and
3. the names, residences and descriptions of the said trustees of such body or association of persons.

The Minister may require a statutory declaration or other evidence to verify the statements and particulars

in the application. The Minister may refuse to grant a certificate of incorporation under the TIA if he is not satisfied that the application has complied with the TIA. It takes approximately 21-30 working days for the incorporation of a trust to be approved by the Minister.

Every application for a certificate of incorporation under the TIA, and every certificate issued, shall be subject to a stamp duty of RM30.00 (RM10.00 X 3 copies).

Other documents to be submitted to the Minister include the following:

- Application form for the establishment of the Foundation
- Certified true copy of identity card for each trustee
- A copy of bankruptcy search result from the Malaysia Department of Insolvency for each trustee
- Letter of appointment of trustees by the said body or association of persons
- Details of the foundation's objectives, vision, mission, financial resources, the activities to be undertaken, the power to appoint the members of the board of trustees, the composition of board of trustees (not exceeding 10 pages)

#### **d. Liabilities**

After a certificate of incorporation has been granted, all trustees of the body or association of persons, notwithstanding their incorporation, shall be chargeable for all property they are responsible for. Further, each person shall be answerable and accountable for their own acts, receipts, neglects and defaults, and for the due administration of the body or association of persons and its property, in the same manner and to the same extent as if no such incorporation had been effected.

#### **e. Tax Treatment**

If the trust qualifies as a public charity under the Income Tax Act 1967, any income earned by a charitable trust may be tax exempt.

#### **f. Ongoing Governance and Regulatory Obligations**

Trustees shall comply with the requirements under the TIA which include, amongst others as follows:

1. If requested, the trustees shall deliver all applications for and certificates of incorporation to the Minister to be preserved.
2. The trustees or trustee of any body or association of persons shall, in books to be kept by them for that purpose, regularly enter or cause to be entered full and true accounts of all money received and paid respectively on account of such body or association. Further, the Trustees shall, on or before 30 June in every year, or any other day as appointed by the Minister, prepare and make out accounts which includes an account of all balances in hand at the commencement of the year and of all monies received during the same year on account of the said body or association.
3. The trustee or trustees shall immediately inform the Minister in the event of voluntary dissolution of body corporate.

The trustee or trustees shall also inform the Minister of any changes to the board of trustee, the address, phone number or any other related matters. The Minister may by order revoke the Certificate of Incorporation if found in breach of any provision of the TIA.

#### **g. Corporate structure**

A trust must be created by way of a trust deed or declaration. The trustees manage the trust fund in accordance with the trust deed and TIA. In addition, the number of trustees for a trust shall be as per set out in the trust deed. Under the TIA, there are no restrictions as to who shall sit in the board of trustee.

#### **h. Governance**

A trust is regulated by the TIA. The trustees or trustee shall become a body corporate by the name described in the certificate, and shall have power to sue and be sued in such corporate name, and subject to the conditions and directions contained in the said certificate to amongst others acquire, purchase, take, hold and enjoy movable and immovable property.

A person shall be disqualified from being a trustee if:

1. he has been convicted of any offence under any law and sentenced to a fine of not less than one thousand ringgit or to imprisonment for a term of not less than one year or to both;
2. there has been made and is in force against him any order of detention, supervision, restricted residence, banishment or deportation, or if there has been imposed on him any form of restriction or supervision, by bond or otherwise, under any law relating to the security of Malaysia or any part thereof, the prevention of crime, preventive detention, restricted residence, banishment or immigration;
3. he is an undischarged bankrupt; or
4. he is, or has been found or declared to be, of unsound mind.

The certificate of incorporation shall have perpetual succession unless it is revoked by the Minister.

#### **i. Finance and fundraising**

The trusts obtain financing through donations, gift and disposition of land or other interests made by deed or trustees.

#### **j. Resources**

- Trustee (Incorporation) Act 1952
- Trustees (Incorporation) (Amendment) Act 2004
- Legal Affairs Division of the Prime Minister's Department [<http://www.bheuu.gov.my/>]



- [www.mymagic.my](http://www.mymagic.my)

## LEGAL STRUCTURE 4 – SOCIETIES

### a. Overview

The establishment of societies is governed by the Societies Act 1966 (“SA”). An unlimited number of members can participate in a society. A society is managed by office-bearers, such as the president, vice-president, secretary, or treasurer.

Societies are accountable to the Registrar of Societies (“ROS”). The ROS is a department under the Ministry of Home Affairs. Until a society is registered, no person may organise or take part in any activity of or on behalf of the society without the permission of the ROS.

The SA has a provision to set up and manage a mutual benefit society, where the voluntary subscription of its members can provide for the relief or maintenance of the members or their family members, for example, when they become unemployed, under distressed circumstances or paying for their funeral expenses.

### b. Advantages & disadvantages

#### Advantages

- ✓ Exemption from certain tax obligations
- ✓ Separate legal entity
- ✓ Limited liability
- ✓ No limit of members
- ✓ Capable of suing and being sued in its own name

#### Disadvantages

- ✗ No sense of ownership as societies do not have shares
- ✗ Limited source of capital
- ✗ Risks of personality clashes between members

### c. Establishment Process

An application to register as a society is to be submitted online at <https://www.eroses.gov.my/>. The application will then be referred to the nearest ROS branch. Generally, the following documents are required for purposes of registration:

- Constitution
- The names of at least 7 members of your society committee
- Minutes of meeting and resolutions stating you want to set up a society

Upon completion of the registration process, the ROS shall issue a certificate with the seal of the society. The

registration fee for a society is RM30.00, which may be paid online.

A society may also establish a branch by applying to the ROS. A processing fee of RM10.00 will be charged.

- d.** A society may sue or be sued in the name of any of its registered public officers. If no such person is registered, the society may be sued in the name of any of its office-bearers. However, a registered society cannot sue or be sued in respect of any contract entered into by any of its branches, unless the society specifically authorised the branch to enter into it.

#### **e. Tax Treatment**

Societies may apply to the Inland Revenue of Malaysia to be exempted from contributing taxes. Only income from transactions with non-members is considered taxable income.

#### **f. Ongoing Governance and Regulatory Obligations**

- Permissions and prohibitions regarding trading activity and reporting  
Every registered society must organise annual general meetings (“AGMs”) and must forward an annual return to the ROS within 60 days of any AGM (or of the end of the calendar year if not held).

The ROS may order any registered society to provide audited accounts, complete returns of the number of meetings held, and list of office-bearers and society or branch members at any time.

- Restrictions on business activity in non-profit/ charity entities  
Where the ROS deems it is necessary for the public interest or interest of any registered society they may order the society not to have any affiliation, connection, or communication with any society, organisation or any other body whatsoever outside Malaysia, or for the society to amend its rules or constitution for office-bearers to be Federal citizens only.

#### **g. Corporate structure**

A registered society may establish a branch with prior approval from the ROS. A subordinate branch can be under the control of another branch called the superior branch, if the members of the superior branch elect and choose the members for the subordinate branch.

#### **h. Governance**

The members may decide and prescribe different types or classes of members with different rights.

According to the SA, the office-bearers or members that manage or assist in the management of collecting money or subscriptions on its behalf have to reside in Malaysia.

#### **i. Finance and fundraising**

Societies are able to receive contributions and have access to public or private grants made available for non-profit organisations.

#### **j. Case study**

Generating Opportunities for Learning Disabled (GOLD) is a social enterprise set up by the Association of Learning Disabilities, District Petaling, Selangor. GOLD’s aim is to enable people with learning disabilities to

maximize their potential as contributing members of society by providing training in producing a wide range of merchandise (from cookies to door gifts).

GOLD has been very successful, but is limited by the restriction against societies receiving loans from banks in Malaysia. In addition, there is a risk of loss to the business if the board of trustees of members decide to remove the current promoters, as those promoters have no ownership in the business.

#### **k. Resources**

- Organisation Rules 1993
  - Societies Act 1966
  - Guidelines to submit Annual Return:  
[http://www.ros.gov.my/files/File/CARA\\_MENGHANTAR\\_PENYATA\\_TAHUNAN\\_Kemaskini\\_27\\_Mei.pdf](http://www.ros.gov.my/files/File/CARA_MENGHANTAR_PENYATA_TAHUNAN_Kemaskini_27_Mei.pdf)
  - Organisation Management Guidelines: <http://www.ros.gov.my/index.php/en/perkhidmatan>
-

## INCOME TAX ACT 1967

### LEGAL STRUCTURE 5 – CO-OPERATIVE SOCIETIES

#### a. Overview

Co-operative societies are governed by the Co-Operative Societies Act 1993 ("CSA"). A co-operative society is an organisation with an objective to increase the economic significance of its members in accordance with cooperative principles. Every member of a co-operative society shall only have one vote in the conduct of the affairs of the co-operative society. Further, a registered co-operative society may adopt its own by-laws.

Co-operative societies are regulated by the Malaysia Co-operative Societies Commission ("MCSC"). The Malaysian Co-operative Societies Commission ("Commission") registers the co-operative societies.

#### b. Advantages and Disadvantages

##### Advantages

- ✓ Limited liability, i.e. limited to the extent of their capital in the co-operative societies
- ✓ Perpetual Existence
- ✓ Open Membership

##### Disadvantages

- ✗ Difficult to form i.e. at least fifty individual persons
- ✗ Lack of interest as the business success requires sustained efforts over a period of time.

#### c. Liabilities

Every co-operative society registered shall be with limited liability.

#### d. Tax treatment

Co-operative societies are taxed on a scale from 0% on the first RM 30,000.00 to 24% for income exceeding RM 750,000.00. Tax exemption will apply if for the first five years of registration, the total members' funds are less than RM750,000.00

#### e. Ongoing governance and regulatory obligations

- Annual general meetings  
Every co-operative society shall hold an annual general meeting of members or delegates not later than twelve months after the close of each financial year or such longer period as may be approved by the Commission.
- Address of co-operative society  
Every co-operative society shall have an address, registered in accordance with this Act, to which all notices and communications shall be sent, and shall inform the Commission of every change of that address.
- Documents to be lodged with the Commission  
Every co-operative society shall lodge with the Commission, amongst others, a list of members of the

board not later than 15 days after its annual general meeting and minutes of all general meetings not later than 30 days after the date of the meeting.

#### **f. Corporate structure**

Every co-operative society should have a Board, an Internal Audit Committee, duly appointed at the annual general meeting.

A co-operative society may continue operating despite the bankruptcy, death or exit of the original members.

A co-operative society may be dissolved by MCSC upon receipt of an application for the dissolution from three-fourths of its members.

#### **g. Governance**

Every co-operative society shall have a board, which shall consist of not less than six and not more than fifteen members duly appointed at the annual general meeting subject to the regulations or orders or directives or guidelines.

#### **h. Finance and fundraising**

Funds may be raised via entrance fees, shares subscribed by members, specific savings of members, deposits or loans from members and non-members as well as donations and grants made by third parties. A co-operative society shall not accept deposits from persons who are not members of that co-operative society unless with the prior approval of the Commission.

The co-operative society may grant credit facilities to its members and employees including the chief executive officer as provided in their schemes of service. Prior approval of the Commission will be required if credit facilities are granted to its subsidiaries or another co-operative society. Such loan or credit facilities granted shall be subject to the directives or guidelines issued by the Commission and by-laws of the co-operative society.

#### **i. Resources**

- The Co-operative Societies Act 1993
  - <http://www.skm.gov.my/index.php/en/hubungi-kami/soalan-lazim>
  - Co-operative Governance Guidelines issued by MCSC
  - Guidelines on Establishment of Co-Operatives issued by MCSC
  - Guidelines on Annual General Meeting issued by MCSC
-

## INCOME TAX ACT 1967

### LEGAL STRUCTURE 6 – COMPANY LIMITED BY GUARANTEE

#### a. Overview

A company limited by guarantee (“CLBG”) works differently from most companies, which are owned by shareholders. No CLBG shall be formed with share capital. The liabilities of the members are limited to the amount provided in the memorandum, which the members undertake to contribute if the company goes into liquidation. In Malaysia, all CLBGs are public companies and hence the general provisions for incorporation of public companies under the Companies Act 2016 (“CA 2016”) will apply. CLBGs are usually formed for non-profit activities.

#### b. Advantages & disadvantages

##### Advantages

- ✓ A CLBG is a separate legal entity, liable for its own actions and debts
- ✓ Liability of members is limited to the guaranteed amount
- ✓ No share transfer is required each time a member leaves
- ✓ Unlimited number of members

##### Disadvantages

- ✗ There are certain restrictions with regard to the company name
- ✗ Difficult to raise finance as shares cannot be issued
- ✗ Withdrawal of money from companies can be difficult.
- ✗ Subject to ongoing public disclosure obligations and statutory control
- ✗ Difficult to give investors a return on their investments

#### c. Establishment process, documentation & costs

Under the CA 2016, a CLBG may only be formed for the following objectives:

- providing recreation or amusement
  - promoting commerce and industry
  - promoting art
  - promoting science
  - promoting religion
  - promoting charity
  - promoting pension or superannuation schemes
  - promoting any other objectives useful for the community or country, such as environment, health, education, research, social or sports
-

A CLBG must ensure that none of its members or directors use the company or its financial resources to conduct any form of political or unlawful activities.

To establish a CLBG, the company must lodge an application with the Registrar of Companies Commission of Malaysia ("CCM") together with its constitution and the incorporation fee of RM3,000.00. The application must also include the details of every director, company secretary and member, and a statement by each promoter or director confirming his consent and qualification to act. A CLBG may apply to the Minister for a licence to omit the word "Berhad" or the abbreviation "Bhd." from its name.

Unlike any other company, a CLBG must have a constitution, containing:

- A. the name of the company;
- B. the objectives of the company;
- C. the amount up to which the members undertake to contribute to the assets of the company in the event of its being wound up;
- D. the full names, addresses and occupations of the subscribers; and
- E. a statement that the subscribers wish to form company under the constitution.

The company may adopt the model constitution prepared by the Registrar which can be found on [www.ssm.com.my](http://www.ssm.com.my).

#### **d. Liabilities**

The liability of CLBG members is limited to the which they undertake to contribute in the event of its being wound up.

#### **e. Tax treatment**

A CLBG with a total capital contribution of RM2.5 million and less at the beginning of the accounting period shall be taxed at the rate of (i) 19% for the first RM 500,000 and (ii) 24% thereafter. Paid-up capital of more than RM2.5 million will be taxed at 24%. Tax exemption applicable to a public company involved in charitable purposes can be obtained from the Ministry of Finance.

#### **f. Ongoing Governance and Regulatory Obligations**

Companies must make certain information public, such as an annual return, financial statements and reports. Particulars and changes in the register of members, directors and company secretary, amendments to the constitution, for example, also need to be filed.

- Annual returns

Every CLBG must lodge an annual return with the Registrar of CCM not later than 30 days from each anniversary of its incorporation date. An annual return must contain general information about a company's registered office address, nature of business, the address of the places where its business is carried on including branches (if any), the address at which its register of members and financial records are kept (if not kept at the registered office), total amount of indebtedness, particulars of directors, managers, secretaries and auditors, and its membership.

- Financial statements and reports

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Every CLBG must prepare annual financial statements that give a true and fair view of the financial position as at the end of the financial year, and the financial performance of the company during the financial year. The financial statements must contain information including but not limited to directors' remuneration, directors' retirement benefits, compensation to directors for loss of office, loans, quasi-loans and other dealings in favour of directors and auditors' remunerations.

A company must lodge financial statements and reports within 30 days of its annual general meeting.

- **Restrictions**

Unless prior approval has been obtained from the Registrar of CCM, a CLBG:

- i. is prohibited from appointing new directors;
- ii. is prohibited from paying any fees, salaries, fixed allowances or benefits to its directors;
- iii. must use the profits and other income for the purposes stated in the objectives of the company;
- iv. is prohibited from soliciting any contribution or donation or make any money collection from the public;
- v. is required to comply at all times with all the provisions set forth in the constitution.

#### **g. Corporate structure**

The structure of a CLBG at board level is the same as for all public companies. A CLBG must have a minimum of two directors and must have at least one secretary. Any purported resignation by a director is invalid if it would reduce the number of directors below two, unless a replacement is appointed. At least two of the directors must ordinarily reside in Malaysia and they must not be alternate or substitute directors.

#### **h. Governance**

A director of a CLBG must be a person who is fit and proper and is not disqualified under the CA 2016. To determine whether a person is fit and proper, the Registrar of CCM may:

- a. consider the experience, qualification and competency of the director which would assist him in carrying out his duties as director of the CLBG;
- b. consider the reputation, character and integrity of the director;
- c. conduct a security vetting on the potential director via the Royal Malaysian Police and/or other agencies.

If the Registrar is satisfied that the applicant is fit and proper and competent to perform the duties of a director under the CA 2016, the Registrar of CCM may approve the applicant as a director of a CLBG.

#### **i. Finance & fundraising**

A CLBG does not have share capital, and as such cannot raise money by issuing or allotting shares to investors. Instead, members will contribute to the assets of the CLBG (usually a nominal amount) on winding-up. The members can also agree to pay a membership fee which would be considered a source of income. Soliciting public contributions or donations is not permitted.

#### **j. Resources**

- Companies Act 2016
- Guidelines on Company Limited by Guarantee issued by the Companies Commission of Malaysia



- Income Tax Act 1967

[WWW.MYMAGIC.MY](http://WWW.MYMAGIC.MY)

## LEGAL STRUCTURE 7 – PRIVATE COMPANY LIMITED BY SHARES

### a. Overview

The most common form of company in Malaysia are private companies limited by shares, which append “Sdn Bhd” to their name as an abbreviation of ‘Sendirian Berhad’ (‘private limited’ in the national language). A private company raises capital by issuing shares to private investors, and each shareholder’s liability is limited to the amount of capital which they hold. For commercial enterprises that intend to operate a business for profit, a private company limited by shares is normally the appropriate vehicle.

Shareholders are not responsible for the company’s debts unless they have given guarantees such as bank loans. However, they may lose the money they have invested in the company if the company fails. Shareholders may be individuals or other companies. However, a private company limited by shares cannot offer its shares to the general public in the same way that a public company can.

The constitution of a private company sets out the internal management structure and procedures of the company.

### b. Advantages and Disadvantages

#### Advantages

- ✓ Separate legal entity, therefore liability of shareholders for the debts of the company are limited to the amount of capital held.
- ✓ Company can enter into contracts in its own name.
- ✓ Ease in raising capital via issuance of shares.

#### Disadvantages

- ✗ Must comply with prescribed procedure of incorporation.
- ✗ Ongoing reporting obligations with the Companies Commission of Malaysia.
- ✗ Prescribed form of accounts and certain company information is publicly available.

### c. Establishment process, documentation & costs

A name search will first need to be done to check the availability of the name for the CCM’s approval. This will usually take up to five business days. Once the company name has been approved, it will be reserved for a period of time within which the incorporation documents will need to be submitted to the CCM. If the documents are complete, a notice of incorporation will usually be issued within five business days upon receipt of the required information and documents.

A company may be incorporated with a minimum of one share, at any value the company decides its shares should be worth, and may have a single individual as both the shareholder and director. The filing fee for incorporation will be RM 1,000.00 regardless of how many shares the company decides to incorporate with. A private company must have a minimum of one director who’s principal place of residence is in Malaysia.

#### d. Liabilities

- Shareholders' liability

The shareholders' liability is limited to the amount of their investment in the company. If the shareholder has purchased shares directly from the company but has not paid for them, they will be liable to contribute to the assets to the amount remaining unpaid on their shares.

- Directors' liability

The directors of a private company also benefit from limited liability so that the company, and not the directors, is liable for its own debts. However, in exceptional circumstances such as where a personal guarantee has been provided to financial institutions, the directors may be personally liable.

#### e. Tax Treatment

Private limited companies are currently taxed at the rate of 24%. Private companies with paid-up capital of RM2.5 million or less are considered to be small to medium enterprises ("SMEs") and are taxed at 19% on the first RM 500,000.00 and at 24% thereafter.

#### f. Ongoing Governance and Regulatory Obligations

- Annual return

Except for the first year after incorporation, all companies must lodge annual returns for each calendar year with the Registrar of CCMs within thirty days of the anniversary of their incorporation date.

- Accounting records

All companies must keep accounting and other records to sufficiently explain their transactions and financial position and enable true and fair profit/loss accounts balance sheets to be prepared. All entries to be made in the accounting and other records must be made within sixty days of the completion of the transactions to which the entries relate.

The records must be kept at the registered office of the company or at such other place as the directors think fit. This can be a place outside Malaysia, provided that the records are sent to and kept at a place in Malaysia to be available for inspection by the directors at all times.

Failure to do so is an offence punishable on conviction by a fine not exceeding RM500,000 or imprisonment for a term not exceeding three years, or both.

- Financial statements

The directors must prepare financial statements within eighteen months from the date of incorporation, and subsequently within six months of its financial year end. These financial statements must be sent to all the parties stipulated in the Companies Act. Private companies must lodge financial statements and reports annually, within thirty days from the financial statements and reports being circulated to its members, which in turn must be within six months of the company's financial year end.

- Other filing requirements

Private companies are also under a duty to abide by the statutory filing requirements and deadlines as provided in the CA 2016, which include but are not limited to the following actions: change in registered office, change in directors, change in register of member and return of allotment of shares.

### g. Corporate Structure

Private companies limited by shares are governed by both their board of directors and their shareholders under the Companies Act and the company's articles of association. The board of directors are responsible for the day-to-day running of the organisation and records its decisions in board minutes. The shareholders have a number of fundamental powers. In particular, the shareholders have the power to dismiss the board.

Certain decisions and changes relating to the company will require shareholder approval either by an ordinary or a special resolution. A special resolution requires shareholders holding at least 75% of the total issued shares of the company to agree, whereas an ordinary resolution requires shareholders holding at least 50% of the total issued shares of the company to agree. For example, variation of class rights and reduction of the company's share capital are among the matters which require a special resolution.

### h. Governance

There are no restrictions in regards to board composition. Foreigners can sit on the board; a foreigner can form a company as the sole shareholder. However, if he wants to be the sole director of the company, he has to fulfil the residency requirement by having a principal place of residence in Malaysia.

### i. Finance & fundraising

The primary advantages of a private company limited by shares is the ability to raise capital from external investors by the issuance of shares, and the ability to enter into commercial contracts without its directors or shareholders risking personal liability.

### j. Case study

SURI is a Social Enterprise that empowers low-income single mothers in the community of Sg. Udang Klang who struggle with financial challenges yet aspire to improve their household income. Their goal is to eliminate hardship and poverty for single mothers and their children. Although there are many benefits to establishing as a limited company for their organisation, the regulatory burden caused by annual audits as set by the Companies Commission of Malaysia is very costly for a newly established social enterprise, and much like some other structures they are unable to work with some corporate entities which required income tax deduction receipts.

### k. Resources

- [www.ssm.com.my](http://www.ssm.com.my)
- Companies Act 2016
- Income Tax Act 1967

#### **Is it advisable to have more than one legal form? (e.g. hybrid structure if I have different forms of income)**

Each form of legal structure has its own advantages, disadvantages and tax treatments. Different form of legal structures could in theory benefit from a wider range of tax allowances and benefits. However, this would depend on the incentives that are being sought and forms of income available.

#### **I already have an organisation registered as a charity/NGO, can I transition to a social enterprise model?**

Yes, it is possible. We understand that there were instances where registered societies became or adopted social enterprise model.



# MYANMAR



# MYANMAR

## INTRODUCTION

Progressing quickly from its landmark elections in November 2015, Myanmar is experiencing a profound transition, witnessing rapid changes in its legal and regulatory landscape, as well as undergoing transformation in its political, social, and economic sectors. These changes have had a significant impact on social contributions. In 2016, for the third consecutive year, Myanmar topped the Charities Aid Foundation's World Giving Index, a leading study on global generosity and charitable behaviour around the world.<sup>1</sup>

With an entrenched culture of charity and giving, it is no surprise that many businesses in Myanmar have a social mission driving their business operations. As the newly-elected democratic government embarks on a wide-ranging reform process in the business sector, social enterprises are emerging as a viable form of combining business activities with a social mission.

The concept of social enterprises in Myanmar is still new, albeit growing in visibility. There is currently no official legal definition of what constitutes a "social enterprise" in Myanmar. Nonetheless, as in other ASEAN countries, self-identified social enterprises that are emerging in Myanmar are typically businesses or organisations which are established with the primary purpose of addressing a social cause, rather than focusing on the maximisation of commercial profits for investors. In Myanmar, most social enterprises revolve around providing access to finance, livelihood enhancement programmes and vocational training.

In the past, there was an absence of a legislative framework dedicated to the governance of social enterprises in the country, resulting in the formation of social ventures with a diversity of legal forms. At present, there continues to be many legal structures available to social entrepreneurs wishing to establish a social enterprise in Myanmar. In making an informed decision concerning the legal structure best suited for their program, social entrepreneurs in Myanmar need to take into account many considerations, including:

- ownership of the social enterprise;
- legal and practical ability to implement planned activities under the preferred structure;
- establishment costs;
- compliance requirements;
- the financing of the social enterprise and how the generated profits will be utilised;
- the nature of the social enterprise and the related industry in which it operates; and
- the tax implications of the social enterprise structure.

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<sup>1</sup>. <https://www.cafonline.org>.

In the next section, we will explore the various legal forms available to social enterprises in Myanmar, and the implications associated with each structure. The legal structures for social enterprises in Myanmar include:

- sole proprietorships and partnerships;
- private companies;
- INGOs and NGOs; and
- cooperative societies.

Also covered in this chapter are the benefits obtained from the different types of additional administrative registrations available to social enterprises under the four different structures mentioned above, such as council registrations, and small and medium enterprise (SME) registrations.

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## LEGAL STRUCTURE 1 – SOLE PROPRIETORSHIPS AND PARTNERSHIPS

### a. Overview

This option is currently only available to Myanmar citizens. A social enterprise can be established by one or more Myanmar citizens as a sole proprietorship or as a partnership. A sole proprietor is essentially a single person who operates a venture on his or her own, and such ventures are generally small in scale with very few employees, if any. The addition of any other owners (co-owners) will turn such an operation into a partnership. Currently, there is no requirement to register sole proprietorships or partnerships with the Directorate of Investment and Company Administration (DICA) of Myanmar, the government agency normally responsible for registering businesses in Myanmar.

However, there is an option for sole proprietors and partners to have their businesses registered with the Central Department of Small and Medium Enterprises Development in accordance with the Small and Medium Enterprises Development Law 2015, which falls under the purview of the Ministry of Industry. Under this SME law, unregistered businesses can be accorded SME registration if the business does not cause fire, health and safety hazards, and brings minimal adverse impacts to the natural and socioeconomic environment.<sup>2</sup> An SME registration opens up access to loans from certain financial institutions not otherwise accessible to unregistered businesses.

### b. Advantages & disadvantages

#### Advantages

- ✓ **Simple and easy.** Since there are no formal set-up, registration, or public reporting requirements, establishment and operation costs for sole proprietorships and partnerships are significantly lower than other forms of social enterprise. Social entrepreneurs are able to kick start their ventures immediately.
- ✓ **Flexibility.** The owner(s) have full authority to decide on the generation, flow, and utilization of profits, and the management of the venture, and are not bound by instructions from a management board or DICA regulations.

#### Disadvantages

- ✗ **Unavailable to foreigners.** Currently, foreigners who wish to conduct any form of business in Myanmar can only do so through the incorporation of a private company with DICA.<sup>3</sup>
- ✗ **No corporate veil.** The lack of a legal entity means sole proprietors and partners do not enjoy limited liability for their business activities. In other words, the owners of an unregistered business are personally responsible for the debts and obligations of the venture, and personal assets of the owners can be seized in order to satisfy any outstanding business debts.
- ✗ **Hinders business opportunities.** Unregistered businesses may not inspire the same level of confidence in the general public as registered ones. This in turn makes it challenging for unregistered small businesses to partner or to do business with other companies, organizations or the government in Myanmar.

<sup>2</sup> Section 19, Small and Medium Enterprises Development Law 2015.

<sup>3</sup> Section 27A, Myanmar Companies Act 1914.



-  **Difficulty in raising finances.** It is difficult for unregistered businesses to obtain large loans to fund their business operations. Lenders may be deterred by the lack of continuity in sole proprietorships and partnerships, as there is increased risk of sudden termination.

### c. Establishment process, documentation & costs

Sole proprietorships and partnerships are not required to register with DICA, so social entrepreneurs opting for this route are free to commence their ventures immediately. One important note is that since there is no official registration with DICA, social entrepreneurs who wish to protect or secure the rights to the names of their ventures should consider recording their trade names as a trademark in Myanmar.

There is no trademarks act in Myanmar, and as a result, the recordal of trademarks is a simple and straightforward process. This is done by way of recording a notarized Declaration of Ownership of Trademark with the Office of Registration of Deeds, a process which can be completed in one to two months. A nominal stamp duty of MMK 200 is payable for a Declaration of Ownership of Trademark. Upon recordal of the trademark, social entrepreneurs can also publish a cautionary notice of their ownership of the trademark in local newspapers.

If the social venture of the sole proprietor or partnership involves the opening of a shop or related establishment, such as a restaurant, a café, a showroom, or a bookstore, an establishment license must be acquired from the respective city council or municipal office. In Yangon, the relevant authority is the Yangon City Development Committee. The required documents to apply for an establishment license at the relevant city council or municipal office differ based on the nature of the establishment, but will typically include the following information / documents:

- Copy of the applicant's National Registration Card
- Three photographs of the applicant
- Documents evidencing the right of possession at the location of the establishment
- Three photographs depicting the location of the establishment showing the precinct, exterior and interior
- Letters of approval from 10 people within the neighborhood of the establishment building who have agreed to, or have no objection to, the business being carried out
- Liquor license or permit, where applicable (e.g. for restaurants selling liquor)
- Recommendation from the fire station of the relevant township
- Recommendation from the health officer of the Township Development Committee Office
- Other documents as deemed necessary by the city council or municipal office

The registration fees for an establishment license vary depending upon the type of business, and range from MMK 50,000 to MMK 150,000 per year. All establishments are also required to pay signboard tax of approximately MMK 5,000 per square foot, varying according to the type of business.

For social entrepreneurs wishing to obtain SME registration, an application must be submitted to the Central Department of Small and Medium Enterprises Development, under the Directorate of Industrial Supervision



and Inspection. The application form issued by the directorate requires a comprehensive list of details to be provided, including:

- general information about the applicant's business, such as the nature and location of the business, investment capital and profits in the past financial year and number of employees; and,
- detailed information about the business, such as its own assessment of the success of its current operations, issues faced during the course of operations, and any existing awards, certifications and permits which it has obtained.

The registration fees are MMK 10,000 for medium-size enterprises and MMK 5,000 for small-size enterprises. In practice, it takes approximately two to three months for an SME application to be processed and approved, upon which an SME Smart Card will be issued to the successful applicant.

#### d. Liabilities

Unlike private companies, sole proprietors and partners do not have a separate legal entity which shields owners from personal liability. As such, a major drawback is that they do not benefit from limited liability, and are personally liable for debts and obligations of the business venture. In short, the exposure to personal liability is high. Therefore, sole proprietorships and partnerships may not offer social entrepreneurs adequate protection against the potential liabilities associated with high-risk industries.

#### e. Tax treatment

Sole proprietors and partners are required to report the income of their ventures on their personal income tax returns. The principal legislation governing income taxes in Myanmar is the Income Tax Law 1974. It is supplemented by the Union Taxation Law, which is re-issued annually to prescribe the applicable tax rates for each fiscal year.

The current personal income tax rates are at a progressive rate of 0-25 percent with a personal deduction for residents of 20 percent of the total salary, capped at MMK 10,000,000:<sup>4</sup>

| Income Bracket                | Progressive Rates |
|-------------------------------|-------------------|
| MMK 1- MMK 2,000,000          | 0 percent         |
| MMK 2,000,001-MMK 5,000,000   | 5 percent         |
| MMK 5,000,001-MMK 10,000,000  | 10 percent        |
| MMK 10,000,001-MMK 20,000,000 | 15 percent        |
| MMK 20,000,001-MMK 30,000,000 | 20 percent        |
| MMK 30,000,001 and above      | 25 percent        |

Income tax is not levied on a person whose annual income is below MMK 800,000.<sup>5</sup> There are also tax allowances for children and spouses, including allowances of MMK 1,000,000 for married couples, MMK 1,000,000 for each parent that lives together with the taxpayer, and MMK 500,000 for every child.<sup>6</sup>

Businesses registered as SMEs enjoy a tax exemption on income not exceeding MMK 10,000,000 annually during the first three years (inclusive of the year of commencement of business). Income tax is assessed on income in excess of MMK 10,000,000 annually during those years.<sup>7</sup>

<sup>4</sup> Sections 19(c) and 20, Union Taxation Law 2017.

<sup>5</sup> Section 19(a), Union Taxation Law 2017.

<sup>6</sup> Section 21, Union Taxation Law 2017.

<sup>7</sup> Section 29, Union Taxation Law 2017.

#### **f. Ongoing governance and regulatory obligations**

There are no applicable governance and regulatory obligations imposed on sole proprietorships and partnerships other than reporting their income and paying income tax. The owners of the social ventures will have full control over the operations, and no formal records are required by law. It is nonetheless good practice for social entrepreneurs to put in place a proper record-keeping system to document expenses and income for tax and other purposes.

For social ventures which have obtained SME registration, the law explicitly places the responsibility of maintaining statistics and records upon the entrepreneurs.<sup>8</sup> However, based on current practice, there is no legal requirement for SMEs to submit annual reports or financial statements to the Central Department of Small and Medium Enterprises Development. Nevertheless, when there are changes to the capital investment, size of workforce and annual income, which render a social venture's SME categorization to be inconsistent with the specifications of its registration, entrepreneurs are obliged to notify the Central Department of Small and Medium Enterprises Development of the changes and obtain a new registration for the SME.<sup>9</sup>

#### **g. Corporate structure**

For social ventures carried out through sole proprietorships or partnerships, no formal structures are required and business decisions are made at the full discretion of the sole proprietor or the partners. Social entrepreneurs can therefore wholly dedicate their time to building and operating the social enterprise. Similarly, no operating agreements are required, although for partnerships, a partnership agreement is strongly recommended.

#### **h. Governance**

Governance of this kind of venture lies entirely in the hands of the individual social entrepreneurs, and normally there is no board or other governing committee. There are no applicable statutory restrictions.

#### **i. Finance & fundraising**

While sole proprietorships and partnerships typically start with limited funds originating from the owners' personal funds or personal loans, larger amounts of capital may be required as the social venture begins to grow. The funding options available to social ventures operating in the form of sole proprietorships or partnerships remain limited. For instance, unlike private companies, a sole proprietor is unable to issue equity interest in order to raise capital for the social venture. It is also challenging for unregistered businesses to obtain large loans from banks and other financial institutions, which typically require proof of business registration and a track record of financially successful operation.

Nonetheless, for social entrepreneurs who have obtained SME registration, SME loans may now be obtained from selected local banks in Myanmar if qualifying requirements are met. No proof of an incorporated company is required, as long as loan applicants can prove their SME registration. Depending on the type and amount of loan obtained, some banks do not require the borrower to provide property as collateral. Repayment terms range from one to five years. According to the Global New Light of Myanmar, a government-owned newspaper published by the Ministry of Information, the Yangon Region Government granted MMK 2.2 billion worth of loans to 98 SMEs in the fiscal year 2016 – 2017.<sup>10</sup>

<sup>8</sup> Section 18(d), Small and Medium Enterprises Development Law 2015.

<sup>9</sup> Section 18(c), Small and Medium Enterprises Development Law 2015.

<sup>10</sup> Global New Light of Myanmar, 5 April 2017, page 5.

Social entrepreneurs can also obtain funding through participation in incubator and accelerator programmes in Myanmar, sponsored by both private and government sources, although most of the programmes are currently focused on technology-based ventures. However, the injection of some of these investments may be contingent upon social entrepreneurs eventually formalizing their business through a DICA registration.

#### **j. Resources**

- SME Development Center, [www.smedevelopmentcenter.gov.mm](http://www.smedevelopmentcenter.gov.mm)
  - Global New Light of Myanmar, [www.moi.gov.mm/npe/nlm/](http://www.moi.gov.mm/npe/nlm/)
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## LEGAL STRUCTURE 2 – PRIVATE COMPANIES

### a. Overview

Social entrepreneurs can register their ventures with DICA as a private company limited by shares under the Myanmar Companies Act 1914. The new Myanmar Companies Law 2017 has been enacted and signed into law in December 2017, but is not yet in force due to administrative requirements which are expected to be implemented in mid-2018. While it is very common for social enterprises to derive income from sales of goods and other forms of trade, trading activities are presently limited to 100 percent locally-owned entities only. Only companies with 100 percent Myanmar shareholding, whether by Myanmar individuals or Myanmar corporate entities, are free to engage in all types of social enterprises. Companies with any foreign shareholding are categorized as foreign companies, and are not allowed to engage in trading activities in Myanmar (though may change upon the entry into force of the new Companies Law 2017, which describes defines foreign company as a locally-incorporated entity in which a foreign entity or foreigner holds at least 35% of its ownership or control). Currently, exceptions are made for joint ventures formed with local citizens for the trade of fertilizers, seeds, pesticides, hospital equipment or construction materials, as well as manufacturing activities, the operation of vocational training centres, and other prescribed activities.

Foreign investors wishing to participate in manufacturing and trading activities without collaboration with local partners can apply to obtain a permit from the Myanmar Investment Commission (MIC) in accordance with the Myanmar Investment Law 2016. However, this is for capital-intensive and large-scale investments only, and therefore may not be feasible for social enterprises. For social ventures wholly owned by Myanmar citizens, there is also an option for registered private companies to obtain SME registration detailed in paragraph (c) of the Sole Proprietorship and Partnership section above, which can lead to tax benefits.

### b. Advantages & disadvantages

#### Advantages

- ✓ **Separate legal entity.** Liabilities of shareholders are limited to the amount paid for their shares and personal assets of shareholders are not at risk.
- ✓ **Ability to raise finance.** The social venture can issue shares to raise its capital. There is also greater access to financing options, such as through bank loans, shareholder loans or increase in capitalization.

Tax deductions for SME-registered companies. For tax benefits available to SME-registered companies, see section (e) below.

#### Disadvantages

- ✗ **Restrictions on foreign shareholding.** Foreign social entrepreneurs may not be able to engage in certain ventures restricted to local citizens. For instance, foreigners are not allowed to be involved in trading and import activities, which is a major obstacle for many foreign social ventures.
- ✗ **Ongoing reporting obligations.** Registered companies are required to regularly comply with reporting and company maintenance obligations (e.g., annual audit and corporate administrative requirements). Such obligations also mean that the social venture's financial statements may be publicly available.

 **Not readily identifiable as a social venture.** A private company may not be eligible for forms of support typically available to non-profit organizations, as companies are generally perceived as profit-seeking entities not concerned with social matters benefitting the public.

### c. Establishment process, documentation & costs

The table below illustrates the establishment process, the required documents, and the administrative fees and costs involved in the establishment of a private limited company in Myanmar:

| No. | Description                                                          | Required Documents                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Costs                                                                                                                                                        |
|-----|----------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1.  | Checking the availability of company name.                           | Company name check form                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | MMK 1,000                                                                                                                                                    |
| 2.  | Obtaining company registration forms and payment of stamp duty.      | <ul style="list-style-type: none"> <li>• Application cover letter</li> <li>• Declaration of registration (Form 1)</li> <li>• Location of registered office form</li> <li>• Declaration of legal version</li> <li>• Certificate of translation</li> <li>• Directors' details (Form 26)</li> <li>• Memorandum of association</li> <li>• Articles of association</li> <li>• Application form for permit (Form A)</li> <li>• Statement of company objectives and undertaking not to conduct trading activities</li> </ul> <p>Other documents to be provided by applicants:</p> <ul style="list-style-type: none"> <li>• Copy of passports of shareholders (if individuals) or</li> <li>• directors' resolution (if a company)</li> <li>• Copy of passports of foreign directors or copy of the national registration card (NRC) of local directors.</li> </ul> | <p>MMK 5,100</p> <p>Stamp Duty:<br/>MMK 65,000 (if authorized capital ≤ MMK 100 million)</p> <p>MMK 165,000 (if authorized capital &gt; MMK 100 million)</p> |
| 3.  | Submission of registration documents to DICA and payment of fees.    | <ul style="list-style-type: none"> <li>• Application cover letter</li> <li>• Declaration of registration (Form 1)</li> <li>• Location of registered office form</li> <li>• Declaration of legal version</li> <li>• Certificate of translation</li> <li>• Statement of company objectives and undertaking not to conduct trading</li> <li>• Directors' details (Form 26)</li> <li>• Memorandum of association</li> <li>• Articles of association</li> <li>• Application form for permit (Form A)</li> <li>• Copy of passport of shareholder and/or directors' resolution</li> <li>• Copy of passport of foreign directors or copy of the NRC of local directors.-</li> </ul>                                                                                                                                                                                | MMK 500,000                                                                                                                                                  |
| 4.  | Issuance of temporary incorporation certificate and permit to trade. | N/A                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | N/A                                                                                                                                                          |

| No. | Description                                                          | Required Documents                                                                                                                                               | Costs                                                                                                                                                                                     |
|-----|----------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 5.  | Transfer of minimum capital.                                         | <ul style="list-style-type: none"> <li>• Credit advice confirming transfer of minimum capital required</li> <li>• Conditions letter signed by company</li> </ul> | Minimum capital:<br><br>USD 50,000 for foreign service companies<br><br>USD 150,000 for other foreign companies<br><br>No minimum capital for 100 percent Myanmar citizen-owned companies |
| 6.  | Issuance of permanent incorporation certificate and permit to trade. | N/A                                                                                                                                                              | N/A                                                                                                                                                                                       |

Apart from incorporating as a private company under the Myanmar Companies Act 1914, social ventures wholly owned by Myanmar citizens can also apply for SME registration detailed in paragraph (c) of the Sole Proprietorship and Partnership section above. The same application procedures apply.

In addition, where the nature of the social venture involves carrying out business at a physical establishment, a city council or municipal office establishment license, as detailed in paragraph (c) of the Sole Proprietorship and Partnership section above, is required.

#### d. Liabilities

In a private company, a shareholder's liability is limited to the amount of their investment in the company, i.e., the amount paid for the shares. A director may be protected by the company for all liabilities incurred during the execution and discharge of duties on behalf of the company.

#### e. Tax treatment

Under Myanmar laws, all companies formed under the Myanmar Companies Act 1914 are considered as residents for tax purposes. Currently, corporate income tax is applied at a flat rate of 25 percent of annual profits.<sup>11</sup> Corporate income tax registration must be done at the Company Circle Tax Office, after which tax identification numbers will be issued. A financial year in Myanmar runs from April 1 of one year to March 31 of the following year (the financial year will run from October 1 to September 30 beginning in 2018-19), and annual tax returns have to be submitted within three months of the end of each financial year, which falls on June 30. Adjustments can be made after submission of annual tax returns, and overpayments can be brought forward in the following fiscal year.

For the income tax payable by employees, employers must withhold tax at the relevant rate every month, and pay it to the tax office at the relevant township within seven days from the date of withholding. The township tax office will issue a tax identification number, together with a tax record book, for each employee when the employer files applicable taxes on their behalf. All taxes paid by the employee will be manually recorded in the tax record book.

<sup>11</sup> Section 23(a), Union Taxation Law 2017.

Private companies registered as SMEs are also eligible to enjoy the tax allowances applicable to SMEs, i.e., a tax exemption for income under MMK 10,000,000 per year during the first three years (inclusive of the year of commencement of business) as mentioned in paragraph (e) of the Sole Proprietorship and Partnership section above.

#### **f. Ongoing governance and regulatory obligations**

The Myanmar Companies Act 1914 requires all companies to maintain proper books of accounts, in Burmese or English, with respect to:<sup>12</sup>

- all sums of money received and expended by the company and the matters in which the receipt and expenditure took place;
- all sales and purchases of goods by the company; and
- the assets and liabilities of the company.

A social enterprise registered as a private company in Myanmar must submit audited financial statements to the Internal Revenue Department by June 30 every year, i.e., three months from the end of the financial year. Companies must also hold their first annual general meeting (AGM) within 18 months of incorporation, and hold at least one general meeting every subsequent year.<sup>13</sup> A set of audited financial statements must be submitted to shareholders at every AGM. In addition, within 21 days of the AGM, an annual return (Form E) must be filed with DICA, containing the following information:

- The meeting date
- Information on shareholders
- A list of directors
- The capital structure of the company

A private company must also submit its annual audited financial statement and AGM minutes to DICA. Moreover, every company is required to submit a copy of every extraordinary and special resolution of the company to DICA within 15 days from the date of the resolution. Company registration is valid for five years, and can be renewed an unlimited number of times (every five years). To renew a company registration, the following information and documents must be provided:

For locally owned companies

- Application form for the renewal of registration
- Updated Form E
- Updated Form 26
- Financial report and annual report of the company
- Certified copy of the income tax clearance from the Internal Revenue Department
- Current address of the company

<sup>12</sup> Section 130, Myanmar Companies Act 1914.

<sup>13</sup> Section 131, Myanmar Companies Act 1914.

For foreign-owned companies

- Application form for the renewal of registration
- Form A
- Specific business activities of the company
- List of directors/shareholders
- Updated Form E
- Audited financial statements for the last two years
- Credit advices relating to any capital brought in
- Copy of Myanmar Investment Commission permit, if applicable
- Updated tour license (for tour companies only)
- Certified copy of the income tax clearance from the Internal Revenue Department

Depending on the nature of the social enterprise, it may also be necessary to obtain certain industry-specific permits.

For example, social enterprises involved in the microfinance industry will have to obtain a microfinance license from the Financial Regulatory Department of the Ministry of Planning and Finance, in accordance with the Microfinance Business Law 2011. Currently, the loans granted by microfinance institutions in Myanmar shall not exceed MMK 500,000, and the interest rates on microcredits are charged at MMK 2.50 per month, without exceeding MMK 30 per year, for every MMK 100 loaned. The application for a microfinance license costs MMK 50,000, and the initial and annual license fees are charged at 0.1 percent of the paid capital. As a note, a non-deposit-taking microfinance institution may be formed with a minimum capital of MMK 100 million, whilst a deposit-taking institution requires a minimum capital of MMK 300 million. The initial license fees must be paid within 15 days of receiving the temporary microfinance license.

Another example of industry-specific permits is for social enterprises involved in the manufacture and sale of food products. These enterprises will need to obtain a food recommendation from the Food and Drug Administration (FDA), under the Ministry of Health. For foreign-owned social enterprises, this can only be done with an MIC permit. In Myanmar, a Certificate of Good Manufacturing Practice (GMP) is mandatory in the food manufacturing industry. The criteria that the FDA considers when issuing GMP recommendations include microorganism detection or chemical tests for safety and quality of the food product, in accordance with the Codex Guideline on General Principles of Food Hygiene CAC/RCP 1-1969. The GMP recommendation is valid for two years and the food manufacturing factory will be inspected three times per year. The Myanmar FDA also encourages food manufacturers to apply for the HACCP (Hazard Analysis and Critical Control Points) certification.

## **g. Corporate structure**

Although the Myanmar Companies Act 1914 makes reference to private companies limited by guarantees, in reality private companies in Myanmar are limited by shares only. DICA provides a model memorandum of association and articles of association, which must be adopted by all private companies. Amendments to these templates are rarely allowed.



## **h. Governance**

The number of shareholders in a private company may range from a minimum of two to a maximum of fifty. A minimum of two directors must also be appointed.

## **i. Finance & fundraising**

A private company structure can facilitate equity investment, as well as loan and debt financing. Private companies can generate financing in several ways: (1) By issuing shares to shareholders within the scope of the companies' authorized capital; (2) By increasing authorized capital; or (3) By borrowing from local banks. Although less common, private companies may also conduct crowdfunding activities. Apart from that, private companies can also raise finance through venture capital funds, although very few social venture capitalists or impact funds are currently making investments in Myanmar.

## **j. Resources**

- "How to Register Your Company in Myanmar," [www.dica.gov.mm/sites/dica.gov.mm/files/uploads/pdf/how\\_to\\_register\\_eng.pdf](http://www.dica.gov.mm/sites/dica.gov.mm/files/uploads/pdf/how_to_register_eng.pdf)
-

## LEGAL STRUCTURE 3 – INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS (INGOS) / NON-GOVERNMENTAL ORGANIZATION (NGOS)

### a. Overview

Some social enterprises opt for a non-profit structure. For those who prefer this route, social enterprises can be registered as NGOs or INGOs in Myanmar in accordance with the Registration of Organizations Law 2014.

An NGO is described in the law as a “local non-profit civil society, organized with five or more persons for the benefit of state and citizens in line with the fundamental rights stated in the constitution and also either for an objective or for an activity or for common interests of the members. The expression includes branches of the organization.” An INGO is defined as “...an organization formed in a foreign country and registered with the Union Registration Board with the intention to perform any social activity within the country.”

### b. Advantages & disadvantages

#### Advantages

- ✓ **Possibility of tax exemption.** INGOs and NGOs are not required to pay tax on income which is used for charitable purposes or social causes.<sup>14</sup> An INGO can also seek approval for further tax exemption after entering into mandatory memorandums of understanding with relevant government ministries concerning services to be provided by the INGO.
- ✓ **Enhancing the focus on social mission.** Social enterprises registering as NGOs and INGOs are able to focus on their social mission, free from the need to expend human and capital resources to seek financial profit from its activities. By contrast, at times, social enterprises registered as private companies may find it difficult to balance its core social mission, which may not be integrated into its company objectives, with its profit generating activities.

#### Disadvantages

- ✓ **Long and unpredictable registration process.** The INGO registration process is long and potentially costly. As part of the process, it is necessary to negotiate and sign a memorandum of understanding with the relevant government ministry for the social activity planned. This usually takes a year, although at least one organization with good intergovernmental connections indicated that they recently obtained an MOU in less than half that time.
- ✓ **Bureaucratic procedures.** Approval from multiple authorities is required, including approvals from the relevant line ministries, the Ministry of Foreign Affairs, the Ministry of Planning and Finance and local authorities at project sites.
- ✓ **Dependency on financial sponsors.** Since NGOs and INGOs do not engage in profit-making activities, they need a reliable source of income from donations, grants and other sources, which tend to be short-term funding, with inconsistent availability for intended projects. INGOs also normally depend on full or partial financial support from their home country organization.

<sup>14</sup> Section 5, Income Tax Law 1974.

### c. Establishment process, documentation & costs

#### Application for NGO

NGOs register by submitting their applications to a registration committee that corresponds to their intended geographic area of social activities, as identified in the chart below.

| No. | Registration Committee                                          | Issuance of Reg. Cert. | Notification of Rejection |
|-----|-----------------------------------------------------------------|------------------------|---------------------------|
| 1   | Union Registration Committee                                    | 90 days                | 30 days                   |
| 2   | Region or State Registration Committee                          | 60 days                | 30 days                   |
| 3   | Nay Pyi Taw Council Registration Committee                      | 60 days                | 30 days                   |
| 4   | Self-administered Region or Self-administered Zone Leading Body | 30 days                | 15 days                   |
| 5   | Divisional Registration Committee                               | 30 days                | 15 days                   |
| 6   | Township Registration Committee                                 | 30 days                | 15 days                   |

A temporary registration certificate will be issued within seven days of submitting the application. The time period for the issuance of the full certificate of registration or notification of rejection depends on the type of registration committee selected by the NGO, as shown above.

The application should contain the following details:

- Name of the NGO
- Address and contact details
- Commencement date of formation
- Objectives
- Activities
- Number of executives
- Number of members
- Fund and assets owned by the organization
- Activities performed
- Organizational structure and scheme
- Other particulars (if any)
- Date of application

Upon approval of its application for registration, the social enterprise registering as an NGO must pay registration fees (where applicable) before the registration certificate will be issued. The associated fees are listed below.

| No. | Registration Committee                                          | Fees        |
|-----|-----------------------------------------------------------------|-------------|
| 1   | Union Registration Committee                                    | MMK 100,000 |
| 2   | Region or State Registration Committee                          | MMK 30,000  |
| 3   | Nay Pyi Taw Council Registration Committee                      | MMK 30,000  |
| 4   | Self-administered Region or Self-administered Zone Leading Body | 0           |
| 5   | Divisional Registration Committee                               | 0           |
| 6   | Township Registration Committee                                 | 0           |

Registration of NGOs must be renewed every five years, but there is no fee for renewals.

## Application for INGO

A social enterprise that wishes to register as an INGO must register as a non-profit organization with the Union Registration Board. To do this, an organization requires the following documents:

- A letter of recommendation from the Ministry of Foreign Affairs
- A letter of recommendation from the Ministry of National Planning and Economic Development
- A letter of recommendation from the relevant line ministry/ministries or organizations associated with the intended core activities of the INGO
- Permission from relevant region or state government or the Nay Pyi Taw Council, based on the location where the social venture will operate

The application dossier must be supported by a completed prescribed form (Form 3) issued by the Ministry of Home Affairs, detailing the following:

- Name of INGO
- Name of chairman
- Name of representative/authorized person
- Location and address, contact phone/fax numbers
- Associated country
- The activities to be conducted in Myanmar
- The names of relevant ministry/ ministries
- Project plan
- Number of executives
- Location of branch office and its address, contact phone/fax numbers
- Name of representative of the branch office
- Application date

The completed application dossier should be submitted to the Union Registration Board in Nay Pyi Taw. A temporary registration certificate will be issued within seven days of submitting the application, and a full certificate of registration will be issued 90 days after the date of approval. Should an application be denied, an official letter will be issued by the Union Registration Board within 30 days.

The registration fee is MMK 100,000. Any changes to the organization's activities or operations require approval from the Union Registration Board. The full registration process for an INGO usually takes about one year or longer. Registration is valid for five years before renewal is required

In addition to the registration process detailed above, social enterprises wishing to be recognised as INGOs in Myanmar are also required to negotiate Memorandums of Understanding with specific line ministries related to the nature of the INGO's social activities to obtain approval to implement programmes. This is a parallel and separate process from registration and usually involves multiple line ministries, as well as the Ministry of National Planning and Economic Development. The MOU requirement does not apply to NGOs.

Currently, there is no specific law, regulation, or comprehensive document outlining the procedures for obtaining MOUs, with the process varying considerably depending on the line ministries involved, geographic areas of operation, and types of activities being proposed or implemented.

MOUs usually take anywhere from one year to upwards of three years to negotiate and secure approval and signing. Certain INGOs have been able to obtain interim 'letters of authorization' from their main line ministry granting them permission to start programs while awaiting formal approval of their MOU. However, this appears to remain at the discretion of individual line ministries and officials.

The MOU consists of three parts, namely:

- **Basic Cooperation Agreement**, to be signed between the INGO and the Government of Myanmar and submitted to the Ministry of National Planning and Economic Development;
- **Project Proposal**, which outlines the intended operations in Myanmar, including the scope of work, regions for program implementation, objectives, activities and relevant personnel; and
- **MOU**, which details the line ministry which an INGO will report its activities to. The MOU also contains other important details of the operations of the organization, such as income tax exemption requests for employees, and more.

#### d. Liabilities

NGOs are treated as juristic persons under Myanmar laws,<sup>15</sup> As such, they have the right to sue or be sued as an organization, but the executive committee members will not be personally liable for the debts and obligations of the organization. The position of INGOs however, is not clearly addressed under the current legislation.

#### e. Tax treatment

None of the Myanmar tax laws refer specifically to INGOs or NGOs, making the exact tax obligations and requirements unclear. In practice, INGOs in Myanmar are eligible for tax exemption but they need to register for tax reporting requirements with the Internal Revenue Department. According to the Income Tax Law 1974, INGOs are not liable to pay any tax on income which is used for charitable purposes or social causes. The act also provides that INGOs in Myanmar can attempt to negotiate general and personal income tax exemptions when entering into MOUs with relevant government ministries, though in practice this may be difficult to achieve.

When tax agreements are made by Myanmar with other countries and international organizations, a notification must be made pursuant to the Income Tax Law 1974, and the terms of such agreements shall be followed as long as they do not conflict with any of the provisions under the law.

#### f. Ongoing governance and regulatory obligations

A registered organization must submit an annual report once per year to the relevant registration body. In accordance with the Registration of Organizations Law 2014, NGOs and INGOs that fail to submit their annual reports for five consecutive years will be regarded as inactive, and will need to apply for a new registration certificate. Under the Association Registration Regulations 2015, NGOs and INGOs must also keep the following records:<sup>16</sup>

- Accounting books of the income and expenses of the organization;

<sup>15</sup> Section 28, Registration of Organizations Law 2014.

<sup>16</sup> Rules 21 and 22, Registration of Organizations Rules 2015.

- Funds, debt, bonds, stock share or debentures owned by the organization; and
- Moveable property and immovable property acquired or rented with funds of the organization.

The annual report and financial statements of social enterprises registered as INGOs and NGOs must also be submitted to the relevant Registration Committee every December. INGOs and NGOs must renew their registrations every five years. There are no renewal fees for NGOs, but INGOs have to pay a renewal fee of MMK 100,000.

### **g. Corporate structure**

An NGO or INGO is governed by its board or committee of executive members. The board or committee makes all pertinent decisions on behalf of the organization, consistent with the approved activities.

Executive committee members of NGOs and INGOs must fulfil the following requirements:<sup>17</sup>

- For NGOs, they must be citizens, associate citizens,<sup>18</sup> or naturalized persons;
- For INGOs, they must be foreigners or persons converted to foreign nationality, or Myanmar citizens;
- Be at least 18 years of age;
- Not a member of a religious order;
- Not currently serving imprisonment terms;
- Not of unsound mind;
- Not a member or person of organizations which are determined by the government as having committed terrorist acts, a member of associations declared as unlawful under any law, or a member of associations abetting such members.

### **h. Governance**

The number of executive committee members to form the board of an NGO or INGO is recommended to be 10-15 people. The curriculum vitae of the executive committee members must also be submitted to the relevant registration board.

### **i. Finance & fundraising**

INGOs and NGOs largely operate through funds garnered via grants and donations. NGOs are expressly allowed to accept aid provided by the government, as well as collect donations in Myanmar.<sup>19</sup>

### **j. Resources**

- "Registration of Business Associations,"  
[www.dica.gov.mm/en/step-by-step/registration-business-associations](http://www.dica.gov.mm/en/step-by-step/registration-business-associations)

<sup>17</sup> Rules 5 and 10, Registration of Organizations Rules 2015.

<sup>18</sup> An "associate citizen" is a category of citizenship provided under the Citizenship Law 1982.

<sup>19</sup> Chapter VIII, Registration of Organizations Law 2014.

## LEGAL STRUCTURE 4 – COOPERATIVE SOCIETIES

### a. Overview

The cooperative option in Myanmar was introduced by the British colonial administration, and was subsequently maintained by the Myanmar military government as a policy to address poverty issues. Today, this legal structure remains as an alternative for local social entrepreneurs in Myanmar to register their social ventures as a manufacturing, service, trading, or general “primary co-operative society” limited by shares under the Cooperative Society Law 1992. Prior to the government reformation in 2016, the governance of co-operative societies in Myanmar fell under the purview of the Ministry of Co-operatives. Today, all matters related to co-operative societies in the country are under the control of the Co-operatives Department of the Ministry of Agriculture, Livestock and Irrigation. Foreigners are not allowed to hold any shareholding in co-operative societies.

### b. Advantages & disadvantages

#### Advantages

- ✓ **Separate legal entity.** Liabilities of members are limited to the amount paid for their shares. Personal assets of shareholders are not at risk.
- ✓ **Ability to raise finance.** Co-operative societies can issue shares to raise capital.

#### Disadvantages

- ✗ **Future uncertainty.** The future of co-operative societies appears to be bleak as the current government of Myanmar is more focused on reforming the country’s archaic company and investment laws. The dissolution of the Ministry of Co-operatives in 2016 resulted in departments under that ministry being transferred to several other government ministries, such as the Ministry of Agriculture, Livestock and Irrigation, where the Co-operatives Department today sits.
- ✗ **Lack of confidence amongst members of the trade and public.** The governance of co-operative societies is said to be tarnished by blurred responsibilities, slow and ineffective management, and a general lack of transparency. This has resulted in a diminished level of credibility and trust by the people.

### c. Establishment process, documentation & costs

Under the Cooperative Society Law 1992, a primary cooperative society may be formed with at least five persons with the aim of collectively promoting the interests of its members.<sup>20</sup> A “cooperative syndicate” can also be formed with at least three primary cooperative societies.<sup>21</sup> In addition, a “union of cooperative syndicates” can further be formed from co-operative syndicates.<sup>22</sup> A primary co-operative society must register as a manufacturing, service, trading, or general co-operative society with the Cooperative Department. To do this, the following documents must be furnished:

- One original and two copies of the application requesting permission to register to form a primary co-operative society;

<sup>20</sup> Section 6, Cooperative Society Law 1992.

<sup>21</sup> Section 7, Co-operative Society Law 1992.

<sup>22</sup> Section 8, Co-operative Society Law 1992.

- One original and two copies of the minutes of the general meeting held to form the primary co-operative society; and
- One original and two copies of the articles of association of the primary co-operative society as agreed and approved by the majority at the general meeting held to form the primary co-operative society.

The application dossier must be supported by the bylaws of the co-operative society, and must contain the following details:<sup>23</sup>

- Name of the cooperative;
- Type of cooperative;
- Address;
- Sphere of business of the cooperative;
- Steps for application to be a member of the cooperative;
- Objectives of the cooperative;
- Business of the cooperative;
- Order of appropriation of the co-operative fund;
- Articles of association that members, member co-operatives or representatives of member co-operatives have to abide by;
- Application screening criteria for members of the co-operative;
- Amount of shares to be subscribed by the members and member societies, and their obligations;
- Manner of cessation of membership, consistent with Section 13 of the Cooperative Society Law 1992;
- Liabilities and assets of the members and member societies;
- Manner of acquisition and formation of capital investment;
- Meetings of the executive committee, general meetings, and voting system;
- System for dividing net profits gained from the business of the cooperative;
- System for transferring shares and rights of the members and member societies;
- Obligations for compiling and maintaining accounts of the cooperative;
- Application form for permission to join as a member or member cooperative; and
- Any other applicable requirements.

The completed application dossier is submitted to the Co-operative Department. The department will scrutinize the application dossiers and if all is in order, they will issue a registration number for the cooperative society, approve the registered seal of the cooperative, the registered name of the cooperative, and the articles of the cooperative society. The department will then require the cooperative to pay the registration fees to the government fund. The current fees are MMK 10,000, and each registration is valid for two years.

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<sup>23</sup> Rule 7, Co-operative Societies Rules 2013.



#### d. Liabilities

A member's liability is limited to the amount of their investment in the co-operative society, i.e., the amount paid for the subscribed shares. As such, when there are claims to be met in the event of liquidation of a co-operative society, the liabilities of a member are limited only to the extent of their subscribed shares.<sup>24</sup>

#### e. Tax treatment

Currently, income tax for major cooperative societies, such as a "cooperative syndicate" or a "union of cooperative syndicates" as mentioned above, is applied at a flat rate of 25 percent on net profits.<sup>25</sup>

However, the income tax for "primary cooperative societies" is assessed at a lesser progressive income tax rate as determined by Union Taxation Law. The current rates are identical to the progressive personal income tax rates detailed in paragraph (e) of the Sole Proprietorship and Partnership section above.<sup>26</sup> percent

Co-operative societies are also required to submit annual tax returns like other business organizations to the Internal Revenue Department within three months from the end of every financial year, i.e., three months from March 31.

#### f. Ongoing Governance and Regulatory Obligations

Cooperative Societies are required to hold an annual general meeting within three months after the end of the financial year. At the general meeting, the following functions may be carried out:<sup>27</sup>-

- Electing the member of the leading committee, the executive committee or board of directors;
- Determining the duties and powers of the member of the leading committee, the executive committee or board of directors;
- Reviewing, discussing and deciding on the manpower report, annual financial statements and audited report of financial statements;
- Deciding on other businesses;
- Administering the profits of the co-operative; and
- Determining future business programs.

The report submitted to the general meeting and the decision record of the general meeting is required to be sent to the Cooperative Department.

The Co-operative Society Law requires all cooperative societies to compile and maintain necessary accounts, inventories and other statements and records.<sup>28</sup> The following statements shall be sent to Cooperative Department:

- Statements of the amount and value of commodity production, service and trade of the co-operative per year;
- Monthly, quarterly, semi-annual, third quarter and annual statements;

<sup>24</sup> Section 15(e), Cooperative Society Law 1992.

<sup>25</sup> Section 23(b), Union Taxation Law 2017.

<sup>26</sup> Section 26, Union Taxation Law 2017.

<sup>27</sup> Rules 35 and 38(c), Cooperative Societies Rules 2013.

<sup>28</sup> Section 17(f), Cooperative Society Law 1992.

- Annual statements, commodity production, trade profit and loss account, and balance sheets for each year.

The accounts of the cooperative society must be audited once every six months and the annual statements must be audited at the end of each year.<sup>29</sup> The audit reports must be sent to the Cooperative Department.

#### **g. Corporate structure**

Members of primary cooperative societies in Myanmar may set the cooperative's overall business direction at the general meeting by majority consent, and the executive committee (sometimes called the board of directors) will implement the decisions made at the general meeting.

#### **h. Governance**

The general meeting is the highest organization of authority for a co-operative society and has the right to decide on all co-operative matters. The executive committee reports to the general meeting and manage the daily activities of the co-operative. The executive committee supervises the co-operative society based on the resolutions of the general meeting.

#### **i. Resources**

- [www.lift-fund.org/sites/lift-fund.org/files/publication/Consultancy-on-Cooperative-Systems\\_English%20\(Sept%202013\).pdf](http://www.lift-fund.org/sites/lift-fund.org/files/publication/Consultancy-on-Cooperative-Systems_English%20(Sept%202013).pdf)

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<sup>29</sup> Rule 68, Cooperative Societies Rules 2013.

## HYBRID / MULTIPLE STRUCTURES

A hybrid structure using a local partner is commonly adopted by foreign investors operating in Myanmar to overcome the general restriction on trading activities imposed upon foreigners. Similarly, foreign social enterprises with a trading component must organize their trading activities through cooperation with a local partner. Hence, a hybrid structure often involves the formation of an INGO, or a foreign owned service company, and the establishment of a working relationship with a 100 percent Myanmar-owned private company. The citizen-owned private company will be tasked to carry out commercial activities. This protects the INGO or service company's assets from the inherent risks of conducting business activities prohibited to them.

Foreign social entrepreneurs wishing to launch their social ventures in Myanmar are highly encouraged to look for an active local counterpart to work with. Where such social ventures involve the sale and distribution of products, such business activities will have to be carried out by the local partner.

Foreign social entrepreneurs should be mindful that the appointment of a nominee is strictly prohibited under local laws. Nominee investments are not recognized, and in the event of a dispute, the foreign principal, who has no legal standing, will be left with no legal options.

## TRANSITIONING BETWEEN LEGAL FORMS

Just as there is currently no recognized primary social enterprise model in the Myanmar legal landscape, there is also no recognized procedure for transitioning between legal forms. Under current practice, a registered or incorporated business cannot transition from its existing legal structure to another legal structure.

A new application for a different legal form has to be filed separately. In other words, a registered NGO or INGO cannot transform into a private company, or vice versa, under the current legal and regulatory framework in Myanmar.

Moreover, it has not historically been possible for shares in a wholly Myanmar-owned company to be transferred to foreigners, to effect a change in company form to become a foreign company. However, in early 2017, one such transition was granted by DICA, although the exact practice for such transitions remains unclear.

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## CASE STUDIES

### Case Study 1 Proximity Designs

A recipient of both the Skoll Foundation's and the Schwab Foundation's awards for social entrepreneurship, the history of Proximity Designs dates back to 2004, when the husband-and-wife team of Jim Taylor and Debbie Aung Din started the country office of International Development Enterprises (commonly referred to as "iDE"), an international nonprofit organization which promotes a business approach to increasing income and creating livelihood opportunities for poor rural households. The organization's initial work focused on creating affordable irrigation products for farmers.

After Cyclone Nargis in 2008, Proximity Designs started to diversify its line of services. Apart from designing and manufacturing irrigation products, the organization created farm recovery services in response to crop failures and pest infestations, formed infrastructure services to rebuild affected areas, provided agricultural advice, and offered product financing and crop loans. In 2011, Proximity Designs started to spin off their crop loans program into an entity called Proximity Finance.

A classic example of the use of a hybrid structure, Proximity Designs was registered as an INGO with a Memorandum of Understanding executed with the Ministry of Agriculture and Irrigation. The product finance and crop loan services are operated under a microfinance license granted by the Financial Regulatory Department of the Ministry of Planning and Finance to Proximity Finance Company Limited, a service company incorporated in 2016.

### Case Study 2 – Yangon Bakehouse

Established in 2012, the Yangon Bakehouse is no stranger to food connoisseurs in Myanmar. The training café, which now operates in two locations in Yangon, is self-identified as a non-profit social enterprise, and generates funding through its cafes and catering services, as well as through corporate sponsors, employment partners, and grant organizations. The Yangon Bakehouse conducts a 10-month training program for disadvantaged women, who undergo training on culinary, English and other life skills. The Bakehouse operates under a license from the Yangon City Development Council, and its café has also obtained SME registration.

### Case Study 3 – Myanmar Business Executives Association

The Myanmar Business Executives Association (MBE) was started by a group of Yangon Institute of Economics MBA alumni through the establishment of the Business Capacity Building Centre (BCBC) in May 2008. The BCBC is registered as an educational training center with the Township Education Office, under the Ministry of Education. Through the BCBC, young business executives and representatives of SMEs are provided training in business, management and leadership skills.

Eventually, MBE was registered as an NGO in 2011, with an MOU executed with the Ministry of Social Welfare, Relief and Resettlement. Today, the MBE has also extended its operations to the provision of microfinance, such as housing loans, agriculture loans, livelihood loans, and hire purchase schemes.

## CONCLUDING REMARKS

The social enterprise sector in Myanmar is ripe and ready for growth. At this point, it is unknown whether there will be changes to the country's law to provide a specific legal structure for the social enterprise model in the near future. The recently enacted Myanmar Companies Law 2017, which is not yet in force, provides an overhaul to the current legal framework for corporate structures, but does not address the social enterprise structures.

It is hoped that specific regulations will be issued to supplement the new Myanmar Companies Law 2017 to bring structural clarity to the growing social enterprise sector in Myanmar. Until then, social entrepreneurs wishing to initiate social ventures in Myanmar have various existing options to consider for their social mission. In the long run, the dynamic impacts of social enterprises in Myanmar can help contribute to better public policy and help strengthen the social enterprise ecosystem in the country.

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# PHILIPPINES



# PHILIPPINES

## INTRODUCTION

The Philippines is a populous country with an estimated 100.9 million citizens.<sup>1</sup> Studies indicate that 26.3% of the population live below the poverty line and 12.1% live in extreme poverty (meaning their earnings are not enough to buy three meals a day).<sup>2</sup> It is estimated that the combined wealth of the richest Filipinos comprises 76% of the country's GDP while 30% of Filipino families live only on an average of 3.67 USD a day.<sup>3</sup>

An emerging social response to this state of poverty is the vibrant growth of social enterprises. Awareness is rising and the country is on the cusp of important policy changes that can lead to social enterprises having a wider presence and impact in the coming years.

There is currently no legal definition of "Social Enterprise" in the Philippines. However, there is a bill entitled Institutionalising the Poverty Reduction through Social Entrepreneurship Program and Promoting Social Enterprises with the Poor as Primary Stakeholders ("PRESENT Bill") pending in Congress which defines "Social Enterprises" as "social mission-driven organizations that conduct economic activities providing goods and/or services directly related to their primary mission of improving the well-being of the poor, basic, and marginalized sectors and their living environment."<sup>4</sup>

The social enterprise movement has been growing in the Philippines for the past several years. In 1999, a group of Non-Governmental Organizations ("NGOs") established the Philippine Social Enterprise Network ("PhilSEN") as a community to discuss and replicate the social enterprise experience. The Ateneo de Manila University has a degree programme in social entrepreneurship and the Institute for Social Entrepreneurship in Asia was established to invest in the pedagogy of social enterprise. The Philippines also has a strong and well-established network of social enterprise actors known as the Poverty Reduction Through Social Entrepreneurship Coalition.

A study published by the British Council and the PhilSEN in 2017 with support from the European Union ("EU") and the United Nations Economic and Social Commission for Asia and the Pacific ("ESCAP") found that there may be as many as 164,473 social enterprises operating in the Philippines whose top objectives are to generate employment, alleviate poverty, improve local communities and empower marginalised groups. They favour inclusion of the most vulnerable and marginalised and provide a platform for voice and economic participation for those left behind.

<sup>1</sup> Philippine Statistics Authority, *Philippines in Figures 2017*, available at [http://psa.gov.ph/sites/default/files/PIF\\_2017.pdf](http://psa.gov.ph/sites/default/files/PIF_2017.pdf) [last accessed 23 November 2017].

<sup>2</sup> The Straits Times, *Philippines is still poor: Philippine Daily Inquirer*, 28 March 2016, available at <http://www.straitstimes.com/asia/se-asia/philippines-is-still-poor-philippine-daily-inquirer> [last accessed: 23 November 2017]; See also Yap, DJ, "12M Filipinos Living In Extreme Poverty," *Philippine Daily Inquirer*, 18 March 2016, available at <http://newsinfo.inquirer.net/775062/12m-filipinos-living-in-extreme-poverty> [last accessed: 23 November 2017].

<sup>3</sup> British Council Philippines, *A Review of Social Enterprise Activity in the Philippines*, August 2015, available at [https://www.britishcouncil.org/sites/default/files/social\\_enterprise\\_activity\\_philippines.pdf](https://www.britishcouncil.org/sites/default/files/social_enterprise_activity_philippines.pdf) [last accessed: 24 November 2017].

<sup>4</sup> Senate Bill No. 176 (2016), available at <https://www.senate.gov.ph/lisdata/23598202261.pdf> [last accessed: 24 November 2017].

## Future Developments

The PRESENT bill, introduced by Senator Paolo Benigno A. Aquino IV, seeks to establish the state policy of pursuing an inclusive growth strategy that promotes an environment conducive to the development and growth of a vibrant social enterprise sector engaged in poverty reduction, and economic and social development. The bill establishes a Social Enterprises Development Council as the primary agency tasked to carry out the promotion, growth, and development of social enterprises in the country. A Social Development Fund is likewise envisioned for inclusion in the annual budget of the Department of Trade and Industry (“DTI”) with an initial amount of Nine Hundred Million Pesos (Php 900,000,000.00) to be granted to social enterprises to accomplish the plans set forth under the PRESENT program.

In this paper, we shall discuss the different legal structures social enterprises may employ in setting up its operations in the Philippines:

1. Sole Proprietorships
2. NGOs
3. Cooperative Societies
4. Corporations
  - a. Stock Corporations
  - b. Non-Stock Corporations
    - i. Foundations



## LEGAL STRUCTURE 1 – SOLE PROPRIETORSHIPS

### a. Overview

One of the quickest ways to set up a social enterprise in the Philippines is through the establishment of a sole proprietorship. A sole proprietorship is the simplest form of a business organization and is not subject to the strict regulatory laws and rules imposed upon corporations and partnerships. A sole proprietorship is essentially an individual person who operates a venture on his or her own which is generally small in scale with few employees. Such an owner has full control and authority over the business, owns all the assets, and is personally liable for business losses. The fact that absolute control over the business is held by one person makes it highly flexible.

Government registration of a sole proprietorship business is simple and easy. This is accomplished by submitting the necessary documents to the Bureau of Trade Regulation and Consumer Protection Department of the DTI.

### a. Advantages and Disadvantages

#### Advantages

- ✓ Easy to set up and register.
- ✓ Requires minimal capitalization.
- ✓ Lower cost in registering for government permits and licenses.
- ✓ Minimal regulations and monitoring requirements.
- ✓ The owner can register and run the business on his/her own.
- ✓ The owner can enjoy the profits on his/her own.

#### Disadvantages

- ✗ Business risk and liability are shouldered by the owner.
  - ✗ Loss is solely suffered by the owner.
  - ✗ The sole proprietor has unlimited liability. Creditors may proceed not only against the assets and property of the business, but also after the owner's personal properties.
- (c) Establishment Process, Documentation, and Costs

The table below outlines the process, required documents, and administrative fees and costs involved in the establishment of a sole proprietorship in the Philippines:

| AGENCY / DURATION                                                                                   | PROCEDURE                                                                                                                                                                                                                                                  | REQUIREMENTS                                                                                                                                                                                                                                                                                              | ESTIMATED COST                                                                                                                                                                                                                               |
|-----------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| DTI –<br>1-2 Days                                                                                   | Search for a business name (online search)<br><br>Register your business name using BTRCP Form No. 16A; list three names in your order of preference. <sup>5</sup>                                                                                         | Tax Identification Number (“TIN”)<br><br>List of three business names still available                                                                                                                                                                                                                     | Fee depends on the scope of your business:<br><br>1. National - Php2,000.00<br>2. Regional - Php1,000.00<br>3. City/Municipality - Php500.00<br>4. Barangay - Php200.00<br><br>Additional fee of Php15.00 for Documentary Stamps Tax (“DST”) |
| Barangay Office (where the business is located) –<br>2 Days                                         | Obtain Barangay Clearance <sup>6</sup>                                                                                                                                                                                                                     | Submit the completed Application Form with the following:<br><br>1. Certificate of business registration from DTI<br>2. Two valid forms of ID<br>3. Proof of address of the sole proprietor’s office such as a contract of lease if rented or original/transfer certificate of title (“OCT/TCT”) if owned |                                                                                                                                                                                                                                              |
| Mayor’s Office – 1 Day                                                                              | Obtain mayoral permit to operate from the licensing section of the city or municipality                                                                                                                                                                    | 1. Completed application form<br>2. Certificate of business registration from DTI<br>3. Barangay Clearance Certificate<br>4. Two valid forms of ID<br>5. Proof of address of the sole proprietor’s office such as a contract of lease if rented or OCT/TCT if owned                                       | The fees vary depending on the city/municipality issuing the mayor’s permit in accordance with its prevailing local ordinances.                                                                                                              |
| Bureau of Internal Revenue (“BIR”) – Regional District Office (“RDO”) where the business is located | 1. Fill out BIR Form 1901 – Application for Registration (for sole proprietor)<br>2. Submit completed registration form together with the requirements in the next table<br>3. Pay registration fee<br>4. Register books of account and receipts /invoices | 1. Certificate of registration from DTI<br>2. Barangay clearance<br>3. Mayor’s business permit<br>4. Proof of address of the sole proprietor’s office such as a contract of lease if rented or OCT/TCT if owned<br>5. Valid ID                                                                            |                                                                                                                                                                                                                                              |

<sup>5</sup> See Department of Trade and Industry, *Business Name Application Form for Sole Proprietor*, available at [http://www.bnrs.dti.gov.ph/c/document\\_library/get\\_file?p\\_l\\_id=30949&folderId=31773&name=DLFE-2201.pdf](http://www.bnrs.dti.gov.ph/c/document_library/get_file?p_l_id=30949&folderId=31773&name=DLFE-2201.pdf) [last accessed: 24 November 2017].

<sup>6</sup> Section 152(c), Republic Act No. 7160.

#### d. Liabilities

Unlike corporations, a sole proprietorship does not have a separate juridical personality that can shield its individual owner from personal liability. The owner consequently has unlimited liability for business debts and obligations. This characteristic makes sole proprietorships highly vulnerable to the potential liabilities associated with high-risk industries.

#### e. Tax Treatment

The income of a sole proprietorship is treated as the personal income of its owner and must therefore be included in his/her individual tax return. This personal income is taxed progressively in accordance with the following rates:<sup>7</sup>

| TAXABLE INCOME                          | TAX RATE                                     |
|-----------------------------------------|----------------------------------------------|
| Not over Php10,000                      | 5%                                           |
| Over Php10,000 but not over Php30,000   | Php500 + 10% of the excess over Php10,000    |
| Over Php30,000 but not over Php70,000   | Php2,500+15% of the excess over Php30,000    |
| Over Php70,000 but not over Php140,000  | Php8,500+20% of the excess over Php70,000    |
| Over Php140,000 but not over Php250,000 | Php22,500+25% of the excess over Php140,000  |
| Over Php250,000 but not over Php500,000 | Php50,000+30% of the excess over Php250,000  |
| Over Php500,000                         | Php125,000+34% of the excess over Php500,000 |

#### f. Governance and Regulatory Obligations

There are no particular governance and regulatory obligations imposed on sole proprietorships other than the reporting of income and paying the corresponding income tax. The owners of social enterprises organized as sole proprietorships will have full control over the operations of the business with no obligation to submit formal records required by law. Nevertheless, it is good practice for sole proprietors to establish a proper record-keeping system to document expenses and income for taxation and other purposes.

#### g. Corporate Structure and Governance

There are no required organizational structures for sole proprietorships. Business decisions are made at the sole proprietor's absolute discretion without any board of directors/trustees or other governing committee. Social entrepreneurs can therefore wholly dedicate their time to building and operating the social enterprise. There are no applicable statutory restrictions.

#### h. Finance and Funding

The funding of sole proprietorships is dependent on the financing scheme of its individual owner. The capital of the business may be raised by infusion of the owner's personal money and assets, the proceeds of a loan or donation, or any other legal means employed to raise money.

#### i. Case Study

Healthy Sweets is a social enterprise producing fair trade and certified organic coconut sugar, candies and teas located in Katipunan, Panabo City, Davao del Norte, Philippines. Healthy Sweets supports the efforts for the economic upliftment of the small coconut farmers in the communities.

<sup>7</sup> Section 24, Republic Act No. 8424 ("Tax Code").

Healthy Sweets was established in April 2009 as a family-run social enterprise. It has been providing green jobs to small farmers through organic coconut farm production and to the women as coconut sugar processors. From this venture, the coconut toppers were able to increase their income two-fold and even three-fold. They were also able to employ women as processors. With the increased incomes, the once unemployed residents could now provide good food for their family and finance the college education of their children.

Using coconut sugar does not only promote a healthy lifestyle but also contributes towards the greening of the earth and mitigating the effects of climate change. Coconut trees provide alternative forest cover that last for many years.

The enterprise was established as a sole proprietorship. In February 2016, Healthy Sweets was incorporated and registered with the Securities and Exchange Commission ("SEC") as Healthy Sweets Mindanao Corporation.

## j. References

- An Act Providing For A Local Government Code of 1991 [LOCAL GOVERNMENT CODE], Republic Act No. 7160 (1991)
  - An Act Amending The National Internal Revenue Code, As Amended, And For Other Purposes [TAX REFORM ACT OF 1997], Republic Act No. 8424 (1997)
  - Department of Trade and Industry, Business Name Application Form for Sole Proprietor, available at [http://www.bnrs.dti.gov.ph/c/document\\_library/get\\_file?p\\_l\\_id=30949&folderId=31773&name=DLFE-2201.pdf](http://www.bnrs.dti.gov.ph/c/document_library/get_file?p_l_id=30949&folderId=31773&name=DLFE-2201.pdf) [last accessed: 24 November 2017]
  - British Council Philippines, A Review of Social Enterprise Activity in the Philippines, August 2015, available at [https://www.britishcouncil.org/sites/default/files/social\\_enterprise\\_activity\\_philippines.pdf](https://www.britishcouncil.org/sites/default/files/social_enterprise_activity_philippines.pdf) [last accessed: 24 November 2017]
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## LEGAL STRUCTURE 2 – NGOS

### a. Overview

NGOs are non-profit organizations that are guided by philanthropic principles. They are usually dependent on grants and donations from international development agencies, corporations, or other entities that allocate a portion of their profits for social missions. Over time, NGOs have had to diversify their sources of income as these traditional sources have significantly lessened.

Some NGOs engage in income generating activities such as providing training and facilitation, management and organizational services, or by setting up profit-oriented companies. The focus of NGOs on their development and sustainability have yielded new development initiatives including the emergence of social enterprises.<sup>8</sup>

PhilSEN, an NGO registered with the SEC, is the secretariat of the PRESENT Coalition which is currently lobbying for the PRESENT Bill in Congress to promote social enterprises as vehicles for poverty reduction.

### b. Advantages and Disadvantages

#### Advantages

- ✓ Fundraising capacity
- ✓ Flexibility
- ✓ Independence
- ✓ Availability of tax exemptions
- ✓ Enhancing the focus on social missions

#### Disadvantages

- ✗ Long and unpredictable registration process
- ✗ Fundraising pressures
- ✗ Less accountability
- ✗ Bureaucratic procedures
- ✗ Dependency on financial sponsors

### c. Establishment Process, Documentation, and Costs

Before establishing a social enterprise as an NGO, the owner should have a clear idea about (1) the purpose of the NGO, (2) its intended beneficiaries, and (3) who will sit on its board of directors. An NGO needs to have at least five but no more than fifteen directors, who must all be of legal age.

When the composition of the board of directors is finalized, it must hold an “Organizational Meeting” to determine the vision and mission of the NGO, stating its primary goal, purpose, and core values. The NGO

<sup>8</sup> Marife M. Ballesteros and Gilberto M. Llanto, “Strengthening Social Enterprises for Inclusive Growth: Philippines 6 (Discussion Paper Series No. 2017-04)”, citing Marie Lisa Dacanay, “Social Enterprise and The Poor: Transforming Wealth”, Quezon City: Institute for Social Entrepreneurship in Asia and Ateneo School of Governance (2013).

should then prepare the minutes of the “Organizational Meeting” and thereafter register with the SEC by submitting four copies of the following documents:

- Articles of incorporation
- By-laws – containing the rules and procedures for the meetings, election of officers, etc.
- Name verification slip
- Affidavit of undertaking to change the corporate name, in case the SEC receives notice that a confusingly similar name has already been registered
- List of members including their respective dates of birth, addresses, and TIN
- List of donors/contributors
- Notarized bank deposit certification,<sup>9</sup> and
- Statement of willingness to allow an audit.

An NGO must also procure an endorsement from the government agency relevant to its purpose. For instance, charitable institutions must obtain an endorsement from the Department of Social Welfare and Development; educational institutions from the Department of Education, the Commission on Higher Education, and/or the Technical Education Skills and Development Authority; and hospitals from the Department of Health.<sup>10</sup>

#### **d. Liabilities**

NGOs have a separate juridical personality from its members and board of directors. As such, NGOs have the right to sue or be sued as an organization and its members and board of directors are not personally liable for the debts and obligations of the NGO.<sup>11</sup>

#### **e. Tax Treatment**

Under section 30 of the National Internal Revenue Code (“Tax Code”),<sup>12</sup> organizations that are non-stock, non-profit, and operated or organized exclusively for charitable purposes are generally granted tax exemptions. However, this tax exemption does not extend to withholding tax, and all NGOs must file tax returns and remit withholding taxes on all income payments that are subject to withholding tax.

An NGO can likewise qualify for a donee institution status which entitles it to tax incentives under the law. The Philippine Council for NGO Certification (“PCNC”) accredits NGOs for this status, subject to the final approval of the BIR. Donations to a donee institution are deductible from the donor’s taxable income and exempted from donor’s tax.<sup>13</sup>

Only donations to accredited NGOs are tax deductible in full. Donations to non-accredited NGOs are tax deductible up to 10% of an individual donor’s income and 5% of a corporate donor’s income.<sup>14</sup>

#### *Registration under the Philippine Council for NGO Certification*

<sup>9</sup> Note the additional requirement of One Million Pesos (Php1,000,000.00) minimum capitalization applicable to foundations.

<sup>10</sup> NGO-PH, *Establishment and Registration*, available at <http://ngoph.com/how-to-start-an-ngo/> [last accessed: 24 July 2017].

<sup>11</sup> Sections 19 and 36(1), Batas Pambansa Bilang 68 (“Corporation Code”).

<sup>12</sup> Republic Act No. 8424.

<sup>13</sup> Section 34(H)(2)(c), Tax Code.

<sup>14</sup> *Id.*, at Section 34(H)(1).

The PCNC is a private, voluntary, non-stock, non-profit corporation whose main function is to certify non-profit organizations that meet established minimum criteria for financial management and accountability in the service of underprivileged Filipinos. It aims to improve the effectiveness of Philippine Civil Society Organizations by becoming more accountable, credible, and capable of providing services to those in need.<sup>15</sup>

Upon registration with the PCNC, a certified NGO will enjoy the following benefits:

- It shall be granted a “Seal of Good Housekeeping.” This is useful for the NGO to attract funding agencies and partners to support and donate to its cause.
- Opportunities for self-assessment, improvement, and assistance with organizational strengthening.
- Donations to certified NGOs are exempt from donors’ tax and fully tax deductible on the part of the donor. However, considering that a social enterprise engages in activities for profit, and profit generation is one of its primary purposes, it cannot be accredited under the PCNC as a non-stock non-profit organization, and thus cannot enjoy the benefits of having a donee institution status.

#### **f. Governance and Corporate Structure**

An NGO is governed by its board of directors. The board of directors makes all the corporate decisions on behalf of the organization, consistent with its approved activities.<sup>16</sup> The board of directors must be composed of at least five but no more than 15 members.

#### **g. Finance and Fundraising**

NGOs usually operate through funds garnered from grants and donations.

#### **h. Case Study**

Sentro ha Pagpauswag ha Panginabuh (SPPI or Center for Local Economy Development)<sup>17</sup> provides financial and training support for Samar’s rural poor.

SPPI’s vision is “[e]conomically and politically empowered men and women, unified by their spirituality (pagpapakatao), in the rural communities of Samar Island.” Its mission is to “[a]dvance the rural communities of Samar Island through local economy development, gender relations, participatory governance and sustainable agricultural practices.”

All of SPPI’s programs are based upon the organization’s Five Pillars of Community-based Local Economy Development:

- Strong Community Organizations – It is the collective capacity of the people who creates their own development goals and guarantee the sustainability of the project.
- Participatory Development Governance – SPPI actively encourages communities to engage in local governance to ensure transparency, accountability and equal representation.
- Livelihoods and Enterprise Development – SPPI identifies economic opportunities and facilitates credit services that are affordable and reliable for the poorest of the poor.

<sup>15</sup> PCNC, *About Us*, available at <http://www.pcnc.com.ph/aboutus.php> [last accessed: 23 November 2017].

<sup>16</sup> Section 23, Corporation Code.

<sup>17</sup> SPPI registered with the SEC as an NGO on September 17, 2007, with Registration No. CN200714633.

- Mainstreaming Gender Perspective – By forming women’s committees, SPPI is empowering women to have a voice in rural and local economic development.
- Ecological Sustainability – All of SPPI’s projects contribute to ecological sustainable development and use natural resources with a long-term vision for building communities.

All of SPPI’s projects contribute to ecological sustainable development and use natural resources with a long-term vision for building communities.

## i. References

- The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Bilang 68 (1980)
  - An Act Amending The National Internal Revenue Code, As Amended, And For Other Purposes [TAX REFORM ACT OF 1997], Republic Act No. 8424 (1997)
  - NGO:PH, *Establishment and Registration*, available at <http://ngoph.com/how-to-start-an-ngo/> [last accessed: 24 July 2017]
  - Marife M. Ballesteros and Gilberto M. Llanto, “Strengthening Social Enterprises for Inclusive Growth: Philippines 6 (Discussion Paper Series No. 2017-04)”, citing Marie Lisa Dacanay, “Social Enterprise and The Poor: Transforming Wealth”, Quezon City: Institute for Social Entrepreneurship in Asia and Ateneo School of Governance (2013)
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## LEGAL STRUCTURE 3 – COOPERATIVE SOCIETIES

### a. Overview

The Philippine Cooperative Act of 2008 (“Cooperative Code”)<sup>18</sup> defines a cooperative as an “autonomous and duly registered association of persons, with a common bond of interest, who have voluntarily joined together to achieve their social, economic, and cultural needs and aspirations by making equitable contributions to the capital required, patronizing their products and services and accepting a fair share of the risks and benefits of the undertaking in accordance with universally accepted cooperative principles. Membership in a cooperative is voluntary and available to all individuals regardless of their social, political, racial or religious background or beliefs. The primary objective of every cooperative is to provide goods and services to its members and thus enable them to attain increased income and savings, investments, productivity, and purchasing power, and promote among them equitable distribution of net surplus through maximum utilization of economies of scale, cost-sharing and risk-sharing without, however, conducting the affairs of the cooperative for eleemosynary or charitable purposes.”<sup>19</sup>

As of December 31, 2014, there are a total of 24,652 registered cooperatives in the Philippines.<sup>20</sup>

### b. Advantages and Disadvantages

#### Advantages

- ✓ Cooperatives that transact only with their members are not subject to any taxes and fees.
- ✓ Cooperatives are exempt from the following:
  - » Payment of local taxes and other taxes on its transactions with banks and insurance companies;<sup>21</sup>
  - » Payment of all court and sheriff’s fees payable to the State for any actions brought under the Cooperative Code of the Philippines.<sup>22</sup>
  - » Putting up a bond for bringing an appeal against a decision of an inferior court or seeking to set aside any third-party claim.<sup>23</sup>
- ✓ Any securities issued by cooperatives are exempt from the Securities Act.<sup>24</sup>
- ✓ Cooperatives doing business with the government are exempted from pre-qualification bidding requirements.<sup>25</sup>
- ✓ Cooperatives may be entitled to free representation by the provincial or city fiscal office or the Office of the Solicitor General, except when the adverse party is the State.<sup>26</sup>

<sup>18</sup> Republic Act No. 9520.

<sup>19</sup> Article 7 as amended, Cooperative Code.

<sup>20</sup> Cooperative Development Authority, Statistics of as of December 31, 2014 available at <http://www.cda.gov.ph/resources/updates/statistics/527-statistics-as-of-december-31-2014> [last accessed July 24, 2017].

<sup>21</sup> Article 61(3) as amended, Cooperative Code.

<sup>22</sup> *Id.*, at Article 61(6) as amended.

<sup>23</sup> *Id.*, at Article 61(7) as amended.

<sup>24</sup> *Id.*, at Article 61(8) as amended.

<sup>25</sup> *Id.*, at Article 61(10) as amended.

<sup>26</sup> *Id.*, at Article 61(11) as amended.

- ✓ Cooperative members receive a patronage fund, a certain percentage of the cooperative's net surplus, after a period of one year.

#### Disadvantages

- ✗ Limited sources of capital.
- ✗ Restricted assignment of share capital contribution or interest.
- ✗ Limited share capital holdings.
- ✗ Members who do not use the services of the cooperative are not entitled to a patronage fund but only to interest on their capital invested in the cooperative.<sup>27</sup>

### c. Establishment Process, Documentation, and Costs

The table below outlines the process, required documents and administrative fees, and costs involved in the establishment of a cooperative in the Philippines:

| DEPARTMENT / DURATION                                                                                                    | PROCEDURE                                                                                                                        | REQUIREMENTS                                                                                                                                                                                                                                                                                                        | ESTIMATED COST                                                                                                                                                                                                                                                                                                                |
|--------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Cooperative Development Authority ("CDA") Central Office – 1 Day                                                         | Reserve cooperative name                                                                                                         | Cooperative name request form                                                                                                                                                                                                                                                                                       | 30 days: Php100.00<br>60 days: Php200.00<br>90 days: Php300.00                                                                                                                                                                                                                                                                |
|                                                                                                                          | Prepare economic survey, articles of cooperation and by-laws; secure bond of accountable officers; execute treasurer's affidavit |                                                                                                                                                                                                                                                                                                                     | Sample documents are available on the CDA website                                                                                                                                                                                                                                                                             |
| CDA Extension Office or CDA Field Office – 1 Day                                                                         | Complete Pre-Membership Education Seminar ("PMES")                                                                               |                                                                                                                                                                                                                                                                                                                     | No fees required                                                                                                                                                                                                                                                                                                              |
| CDA Central Office or CDA Extension Office – 10 days for Field Validation <sup>4</sup> hours for evaluation of documents | Registration                                                                                                                     | <ol style="list-style-type: none"> <li>1. Economic survey, articles of cooperation, and by-laws duly notarized (4 copies);</li> <li>2. Security bond of accountable officers;</li> <li>3. Treasurer's affidavit;</li> <li>4. Approved cooperative name reservation slip;</li> <li>5. Certificate of PMES</li> </ol> | <p>The initial registration fee shall be 1/10 of 1% of the paid-up capital or the basic fee below, whichever is higher:</p> <p>Laboratory cooperatives –<br/>Php50.00</p> <p>Primary cooperatives –<br/>Php500.00</p> <p>Secondary cooperatives –<br/>Php2000.00</p> <p>Tertiary cooperatives –<br/>P3000.00<sup>28</sup></p> |

<sup>27</sup> Cooperative Development Authority, *Basic Info on Cooperatives*, available at <http://www.cda.gov.ph/index.php/resources/downloads/other-information> [last accessed July 21, 2017].

<sup>28</sup> CDA Memorandum Circular No. 2016-08, *Amended Schedule of Registration Fees* (October 18, 2016).

#### d. Liabilities

The Cooperative Code grants limited liability to a registered cooperative which means that its members shall only liable for the debts and obligations of the cooperative to the extent of their individual contributions to the shared capital.<sup>29</sup>

However, directors, officers and committee members of the cooperative shall become jointly and severally liable for all damages to the cooperative, members, and other persons if they:<sup>30</sup>

1. willfully and knowingly vote for or assent to patently unlawful acts.
2. are found guilty of gross negligence or bad faith in directing the affairs of the cooperative; or
3. acquire any personal or pecuniary interest in conflict with their duty as such directors, officers or committee members.

#### e. Tax treatment

Cooperatives which do not engage in any business with non-members or the general public shall not be subject to any taxes and fees.<sup>31</sup> Cooperatives doing business with both members and non-members shall be subject to other rules, but transactions with members shall remain non-taxable.<sup>32</sup>

#### f. Governance and Regulatory Obligations

A cooperative must have an official postal address, and any changes to such address should be reported and registered with the CDA immediately.<sup>33</sup>

Cooperatives must prepare and maintain the following reports:<sup>34</sup>

1. Cooperative Annual Performance Report ("CAPR");
2. Social audit report, including its program of activities and achievements at the end of the fiscal year;
3. Performance report;
4. Audited financial statements duly received by the BIR; and
5. List of officers and trainings undertaken/completed.

#### g. Corporate Structure

Cooperatives are democratic organizations and their affairs are administered by persons elected or appointed in a manner agreed upon by the members. Members may either be regular or associate, with only regular members having the right to vote.<sup>35</sup>

<sup>29</sup> Article 29 as amended, Cooperative Code.

<sup>30</sup> *Id.*, at Article 45 as amended.

<sup>31</sup> *Id.*, at Article 60 as amended.

<sup>32</sup> See Article 61 as amended, Cooperative Code.

<sup>33</sup> *Id.*, at Article 51 as amended.

<sup>34</sup> Section 2, Rule 8 of the Implementing Rules and Regulations of the Cooperative Code.

<sup>35</sup> Article 26 as amended, Cooperative Code.

The general assembly is composed of only of members who are entitled to vote under the Articles of Cooperation and By-laws.<sup>36</sup>

The board of directors is composed of at least five but no more than 15 directors, elected by the members.<sup>37</sup> The board of directors is charged with the direction and management of the affairs of a cooperative. It is responsible for the strategic planning, direction-setting, and policy-formulation activities of the cooperative. Similar to a corporation, the board of directors elects officers of the cooperative or creates an executive committee as provided under its by-laws.<sup>38</sup>

## **h. Governance**

It is the policy of the state to foster the creation and growth of cooperatives as a practical vehicle for promoting self-reliance, and harnessing people power, towards the attainment of economic development and social justice.<sup>39</sup> Membership in cooperatives is strictly for Filipinos. Foreigners are prohibited from becoming members of a cooperative and serving as part its board of directors.

## **i. Finance and Fundraising**

Cooperatives may derive their capital from any and all of the following sources:<sup>40</sup>

1. Members' share capital;
2. Loans and borrowings including deposits;
3. Revolving capital which consists of the deferred payments of patronage refunds, or interest on share capital; and
4. Subsidies, donations, legacies, grants, aids and such other assistance from any local or foreign institution, whether public or private.

## **j. References**

- An Act Amending The Cooperative Code of the Philippines Known as the "Philippine Cooperative Act of 2008" [COOPERATIVE CODE OF THE PHILIPPINES], Republic Act No. 9520 (2009)
- Implementing Rules and Regulations of the Philippine Cooperative Code (2009)
- Amended Schedule of Registration , CDA Memorandum Circular No. 2016-08, (October 18, 2016)
- Cooperative Development Authority, Statistics of as of December 31, 2014 available at <http://www.cda.gov.ph/resources/updates/statistics/527-statistics-as-of-december-31-2014> [last accessed July 24, 2017]
- Cooperative Development Authority, *Basic Info on Cooperatives*, available at <http://www.cda.gov.ph/index.php/resources/downloads/other-information> [last accessed July 21, 2017]

<sup>36.</sup> *Id.*, at Article 32 as amended.

<sup>37.</sup> *Id.*, at Article 37 as amended.

<sup>38.</sup> *Id.*, at Article 43 as amended.

<sup>39.</sup> *Id.*, at Article 2 as amended.

<sup>40.</sup> Article 72 as amended, Cooperative Code.

## LEGAL STRUCTURE 4 – CORPORATIONS

A **corporation** is an artificial being created by operation of law, having the right of succession and the powers, attributes, and properties expressly authorized by law or incident to its existence.<sup>41</sup> A corporation may either be a *stock corporation* or *non-stock corporation*, depending on the existence of shares in its ownership structure.

### A. STOCK CORPORATION

#### a. Overview

A stock corporation is a corporation with authorized capital stock divided into shares of stock either with or without par value. A stock corporation is engaged in income-generating activities and is authorized to declare dividends.<sup>42</sup>

#### b. Advantages and Disadvantages

##### Advantages

- ✓ A corporation has a separate juridical personality from its stockholders enabling it to act independently, and sue or be sued, in its own capacity.<sup>43</sup>
- ✓ Corporate succession allows the corporation to exist notwithstanding any change in its ownership or leadership.<sup>44</sup>
- ✓ Owners are not personally liable for the debts and obligations the corporation may incur in the course of its business.
- ✓ Stockholders may dispose of and transfer their shares of stock at will, subject to requirements under the law and the corporate by-laws.<sup>45</sup>
- ✓ Management or decision making is centralized with the board of directors.<sup>46</sup>

##### Disadvantages

- ✗ Higher capital requirements and operating costs.
- ✗ Double taxation. Both the income of the corporation and the dividends received by shareholders will be subject to income tax.<sup>47</sup>
- ✗ Higher tax rates.<sup>48</sup>
- ✗ More legal regulation and reportorial requirements.
- ✗ Incorporation is costly.
- ✗ Difficult to dissolve.<sup>49</sup>

<sup>41</sup> Section 2, Corporation Code.

<sup>42</sup> Section 3, Corporation Code.

<sup>43</sup> *Id.*, at Sections 19 and 36(1).

<sup>44</sup> *Id.*, at Section 36(2).

<sup>45</sup> *Id.*, at Section 63.

<sup>46</sup> *Id.*, at Section 23.

<sup>47</sup> Sections 24(B)(2) and 27, Tax Code.

<sup>48</sup> *Id.*, at Section 27.

<sup>49</sup> See Sections 117-122, Corporation Code.

### c. Incorporation Process, Documentation, and Costs

The incorporation process with the SEC is as follows:<sup>50</sup>

| SEC INCORPORATION PROCEDURE                            |                                                                           |                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                                                                                                         |
|--------------------------------------------------------|---------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|
| STEP / DURATION                                        | APPLICANT / CLIENT                                                        | GUIDELINES                                                                                                                                                                                                                                                                                                                                                                                                                                         | FEES                                                                                                    |
| STEP 1 – 10 minutes                                    | Create an account online with the SEC company registration system (“CRS”) | Provide a valid email address to log-in and to which all registration communications will be sent.                                                                                                                                                                                                                                                                                                                                                 | None                                                                                                    |
| STEP 2 – 5 minutes                                     | Select application type                                                   | There will be a dropdown list prompting the applicant to select the type of application from. Select “Primary Registration”.                                                                                                                                                                                                                                                                                                                       | None                                                                                                    |
| STEP 3 – 10 minutes                                    | Verify/reserve proposed company name <sup>51</sup>                        | If the proposed name is allowed by the system, click Validate and Add. An email notification will be sent on the approval or disapproval of the company name.<br><br>In case of disapproval, an appeal may be filed using CRS.                                                                                                                                                                                                                     | None                                                                                                    |
| STEP 4 <sup>52</sup> – 10 – 20 minutes                 | Add company details                                                       | Fill-up the respective forms to generate the articles of incorporation or partnership, by-laws, and other company registration documents.<br><br>Confirm the inputted company details. A payment assessment will thereafter appear to inform applicant how much needs to be paid.<br><br>Download and print the system-generated articles of incorporation or partnership and by-laws and other requirements and confirm the registration summary. | None                                                                                                    |
| STEP 5 – Within 30 days of confirming company details. | Upload incorporation documents                                            | Upload the unsigned articles of incorporation or partnership and by-laws together with the other incorporation requirements (SEC forms for these are available at <a href="http://www.sec.gov.ph">www.sec.gov.ph</a> ) under forms and fees.<br><br>Submit completed forms and wait for email notification providing for either the payment procedure or list of documents for compliance.                                                         | None                                                                                                    |
| STEP 6 – 30 – 60 minutes                               | Pay the assessed fees                                                     | Print the order of payment from the email payment advice.<br><br>Log-in to CRS, choose a payment method, and pay the prescribed fees and charges to any of the following:<br>1. Landbank ePayment<br>2. Landbank on Collection<br>3. SEC Cashier/Over the Counter<br>4. Point of Sales                                                                                                                                                             | Consolidated schedule of fees and charges is provided in SEC Memorandum Circular No. 3, series of 2017. |
| STEP 7 – 30 minutes                                    | Upload proof of payment                                                   | Upload the official receipt/proof of payment with the signed and notarized articles of incorporation or partnership and by-laws and other documentary requirements.<br><br>An email notification will be sent advising when the original copies of the incorporation documents shall be submitted.                                                                                                                                                 | Notarization fee: approximately Php500.00                                                               |
| STEP 8 – 30 – 60 minutes                               | Submit the original incorporation documents                               | Upon receipt of email notification advising submission, submit the original and notarized articles of incorporation or partnership and by-laws and other incorporation documents with the Company Registration and Monitoring Department of the SEC.                                                                                                                                                                                               | None                                                                                                    |
| STEP 9 – 60 – 180 minutes                              | Claim the Certificate of Registration                                     | The original documents submitted will be verified. If found to be complete and in order, the following may be claimed on the same day:<br>1. Certificate of incorporation<br>2. Submitted documents<br>3. Unified Registration Record (“URR”) bearing the employer’s registration numbers issued by the SSS, Pag-IBIG, and PhilHealth, and company TIN issued by the BIR.                                                                          | None                                                                                                    |

<sup>50</sup> SEC, *Primary Registration of Stock Corporations*, available at <http://www.sec.gov.ph/services-2/company-2/registration/primary-registration/stock-corporation-registration/> [last accessed: 25 November 2017]; See also SEC, *Company Registration System*, available at <https://crs.sec.gov.ph/> [last accessed: 25 November 2017].

<sup>51</sup> In accordance with SEC Memorandum Circular No. 21, series of 2013.

<sup>52</sup> Note that STEPS 1 and 2 need to be accomplished within four (4) days otherwise the application and reserved name will expire.

The pre-registered TIN of the corporation is automatically generated by the SEC Head Office upon registration. Nevertheless, the company must still register with the BIR to identify its applicable tax types, pay its annual registration fee, and obtain its stamp sales invoices, receipts and books of account.

The following are the documentary requirements for incorporation:

#### *Basic Requirements*

1. Name verification slip (may be secured online or at SEC Name Verification Unit)
2. Articles of incorporation and by-laws
3. Treasurer's affidavit stating that the deposit of the required minimum paid-in capital has been made in the corporation's treasurer in-trust account
4. Joint affidavit of two incorporators to change corporate name (not required if already stated in articles of incorporation)

#### *Additional Requirements*

1. Endorsement/clearance from other government agencies, if applicable. For instance, the following clearances are required for corporations governed by special laws:
  - a. Philippine Economic Zone Authority ("PEZA") for applicants under R.A. 7916;
  - b. Subic Bay Metropolitan Authority (SBMA) or Clark Development Corporation (CDC) for applicant under R.A. 7227;
  - c. Cagayan Economic Zone Authority (CEZA) for applicant under R.A. 7922.<sup>53</sup>
2. Clearance from other SEC departments, if applicable.<sup>54</sup>
3. For corporations with more than 40% foreign equity, an application form for registration under the Foreign Investments Act of 1991<sup>55</sup>

Additional requirements are necessary in cases where incorporators' subscription payments are made through non-cash assets.<sup>56</sup>

<sup>53</sup> SEC, *Documentary Requirements for Stock Corporation: Cash Payment for Subscription*, available at <http://www.sec.gov.ph/services-2/company-2/registration/primary-registration/stock-corporation-registration/> [last accessed: 24 November 2017].

<sup>54</sup> SEC, *Businesses Requiring Endorsements From Other Departments of the Commission/Other Government Agencies*, available at <http://www.sec.gov.ph/wp-content/uploads/2015/01/Endorsement-Clearance.pdf> [last accessed: 24 November 2017].

<sup>55</sup> Republic Act No. 7042, as amended.

<sup>56</sup> See SEC, *Documentary Requirements for Stock Corporation: Non Cash Payment for Subscription*, available at [http://www.sec.gov.ph/wp-content/uploads/2015/01/Doc\\_Reqts\\_Stock\\_Non\\_Cash1.pdf](http://www.sec.gov.ph/wp-content/uploads/2015/01/Doc_Reqts_Stock_Non_Cash1.pdf) [last accessed: 24 November 2017].

In addition to SEC registration, the following requirements from other government agencies and local government units must be procured:

| AGENCY / DURATION                              | ACTIVITY                                                            | GUIDELINES                                                                                                                                                                                                                                                             | FEES                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|------------------------------------------------|---------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Barangay office – 1 Day                        | Obtain barangay clearance                                           | Documentary requirements for barangay clearance:<br>1. Application form<br>2. SEC certificate of incorporation<br>3. Approved articles of incorporation and by-laws<br>4. Location plan/site map<br>5. Contract of lease or OCT/TCT covering the corporation's office. | Barangay fees vary since each barangay has discretion to impose their own fees and charges, provided these fees are reasonable and within the limits set by the Local Government Code and City Ordinances.<br><br>Approximately Php300.00 – Php1000.00                                                                                                                                                                                                                                                                                      |
| City treasurer's office – 1 Day                | Pay the annual community tax and obtain a community tax certificate | A basic and additional community tax is payable based on an assessment of the company.                                                                                                                                                                                 | The basic community tax rate depends on whether the company is a corporation, partnership, or association (Php500.00 or lower). The additional community tax (not to exceed Php 10,000.00) depends on:<br><br>1. the assessed value of the real property the company owns in the Philippines at the rate of Php2.00 for every Php5,000.00; and<br><br>2. its gross receipts, including dividends or earnings, derived from business activities in the Philippines during the preceding year, at the rate of Php2.00 for every Php 5,000.00. |
| Business Permits and Licensing Office – 6 Days | Obtain a Business Permit to Operate                                 | Barangay clearance is a prerequisite for issuance of a Business Permit to Operate.                                                                                                                                                                                     | The fees vary depending on the LGU issuing the permit. Other permits, such as location clearance, fire safety and inspection certificate, sanitary permit, certificate of electrical inspection, mechanical permit, and others may also be required depending on the nature of the business.<br><br>The rate of these fees depends on the nature of business and land area occupied by the proposed corporation.                                                                                                                            |



|                                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                                                                                                                                                                                       |
|--------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| BIR – 1 day                                                                                      | <p>Apply for a Certificate of Registration (“COR”) and TIN from the BIR.</p> <p>After the taxpayer obtains the TIN, the company must pay the annual registration fee of Php500.00 at any duly accredited bank, using payment form BIR Form 0605.<sup>57</sup></p> <p>All newly formed corporations subject to SEC registration are issued pre-generated TIN by SEC-Head Office, which is indicated on their SEC certificate of registration. The corporation only has to register its pre-generated TIN with the BIR and report all internal revenue taxes that it expects to be liable for.</p> | <p>A COR application must be accompanied by:</p> <ol style="list-style-type: none"> <li>1. Completed BIR Form No. 1903 (Application for Registration for Corporations);</li> <li>2. Payment form (BIR Form No. 0605);</li> <li>3. SEC certification of incorporation;</li> <li>4. Articles of incorporation and by-laws;</li> <li>5. Contract of lease (with BIR Form No. 2000 and supporting BIR payment form as proof of payment of documentary stamp tax on the lease agreement);</li> <li>6. DST return (BIR Form No. 2000) on the original issuance of shares and payment form (for the DST payment); and</li> <li>7. Mayor’s permit/business permit application (duly stamped received by the Business Licensing Division of the local government).</li> </ol> |                                                                                                                                                                                       |
| BIR – 1 day                                                                                      | Pay the registration fee and Documentary Stamp Tax at the AAB                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <p>The rate of DST on original issuance of shares of stock shall be Php1.00 for every Php200.00 or fractional part thereof, of the par value, of such shares of stock.<sup>58</sup></p> <p>The DST return shall be filed and the tax paid on or before the fifth (5th) day after the close of the month of approval of SEC registration.</p>                                                                                                                                                                                                                                                                                                                                                                                                                         | <p>Registration fee (Php500.00) + DST on original issuance of shares of stock.</p> <p>DST on the lease contract is not included in the computation of the costs of incorporation.</p> |
| BIR – 1 day                                                                                      | Obtain authority to print receipts and invoices <sup>59</sup>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <p>To obtain authority to print receipts and invoices from the BIR, the company must submit the following documents to the Revenue District Office (“RDO”):</p> <ol style="list-style-type: none"> <li>1. Duly completed application for authority to print receipts and invoices (BIR Form No. 1906);</li> <li>2. Job order;</li> <li>3. Final and clear sample of receipts and invoices (machine-printed)</li> <li>4. Application for registration (BIR Form No. 1903); and</li> <li>5. Proof of payment of annual registration fee (BIR Form No. 0605).</li> </ol>                                                                                                                                                                                                | None                                                                                                                                                                                  |
| <p>BIR – 7 days for printing</p> <p>1 day for stamping</p>                                       | <p>Print receipts and invoices at the print shop</p> <p>Procure books of accounts and printer’s certificate of delivery (“PCD”) stamped by the BIR<sup>60</sup></p>                                                                                                                                                                                                                                                                                                                                                                                                                              | <p>After printing the receipts and invoices, the printer issues a PCD to the company, which must submit it to the appropriate BIR RDO (i.e., the RDO with jurisdiction over the company’s principal place of business) within 30 days for registration and stamping.</p> <p>The company must also submit a copy of the PCD to the BIR RDO with jurisdiction over the printer’s principal place of business.</p>                                                                                                                                                                                                                                                                                                                                                      | None                                                                                                                                                                                  |
| <p>SSS<br/>PhilHealth<br/>Pag-IBIG</p> <p>SSS – 1 day</p> <p>Philhealth and Pag-IBIG – 1 day</p> | Register the corporation and its employees with the SSS, Philhealth, and Pag-IBIG.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | Although the SEC Registration generates the employer’s registration numbers with the SSS, PhilHealth, and Pag-IBIG, the company must still go to these agencies and fill in the necessary forms to complete its records and register its employees.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Applicable fees as imposed by SSS, PhilHealth, and Pag-IBIG.                                                                                                                          |

<sup>57</sup> Section 236(B), Tax Code.

<sup>58</sup> Section 175, Tax Code.

<sup>59</sup> *Id.*, at Section 238.

<sup>60</sup> Section 232, Tax Code.

#### d. Liabilities

The corporation, as a separate juridical entity, is primarily liable for corporate debts and obligations. Stockholders are liable only to the extent of their respective investments in the capital of the corporation. Officers are generally also not liable for acting as mere agents and representatives of the corporation.<sup>62</sup>

#### e. Tax Treatment

Corporations are taxed differently from individuals (and sole proprietorships). The tax treatment of corporations depends on whether it is a domestic corporation, resident foreign corporation, or non-resident foreign corporation. The following are the differences in tax treatment for the three types of corporations:

|                   | DOMESTIC CORPORATION                                                                                                                                                                                                  | RESIDENT FOREIGN CORPORATION                                                                                                                                                                                          | NON-RESIDENT FOREIGN CORPORATION                                              |
|-------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------|
| Sources of Income | Taxed on income from sources <b>within and without</b> the Philippines <sup>63</sup>                                                                                                                                  | Taxed only on income from sources <b>within</b> the Philippines <sup>64</sup>                                                                                                                                         | Taxed only on income from sources <b>within</b> the Philippines <sup>65</sup> |
| Tax Rate          | 30% <sup>66</sup>                                                                                                                                                                                                     | 30% <sup>67</sup>                                                                                                                                                                                                     | 30% <sup>68</sup>                                                             |
| Special Tax Rate  | May choose to be taxed based on its gross income at a rate of 15%, subject to the conditions under section 27(A) of the Tax Code.<br><br>Subject to minimum Corporate Income Tax of 2% of gross income. <sup>69</sup> | May choose to be taxed based on its gross income at a rate of 15%, subject to the conditions under section 27(A) of the Tax Code.<br><br>Subject to minimum Corporate Income Tax of 2% of gross income. <sup>70</sup> | No option of being taxed based on gross income.                               |

Further, there are certain types of passive income which are subject to tax, depending on the source and which corporations are taxed.

#### f. Prevailing Regulations and Reportorial Requirements

##### *Reportorial Requirements*

The SEC imposes the following reportorial requirements on both registered stock and non-stock corporations:<sup>71</sup>

| DOCUMENT TYPE                      | DESCRIPTION                                                               | DEADLINE                                                                                            |
|------------------------------------|---------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| General information sheet ("GIS")  | GIS must be certified and sworn to by the corporate secretary.            | Within 30 calendar days from the actual date of the annual stockholders' meeting                    |
| Annual financial statement ("AFS") | AFS must be stamped "RECEIVED" by the BIR. There is no prescribed format. | Within 120 calendar days after the end of the fiscal year, as indicated in the financial statements |

<sup>61</sup> Sections 19 and 36(1), Corporation Code.

<sup>62</sup> *Id.*, at Section 31.

<sup>63</sup> Section 23(E) and 27, Tax Code.

<sup>64</sup> *Id.*, at Section 23(F) and 28(A).

<sup>65</sup> *Id.*, at Section 23(F) and 28(B).

<sup>66</sup> *Id.*, at Section 27.

<sup>67</sup> *Id.*, at Section 28(A).

<sup>68</sup> *Id.*, at Section 28(B).

<sup>69</sup> Section 27(E), Tax Code.

<sup>70</sup> *Id.*, at Section 28(A)(2).

<sup>71</sup> See SEC Citizens Manual on Reportorial Requirements, available at <http://www.sec.gov.ph/wp-content/uploads/2015/10/Citizens-Manual-on-Reportorial-Requirements.pdf> [last accessed: 24 November 2017].

## g. Governance and Corporate Structure

Corporations have centralized management, which means that all business decisions are made by the board of directors. The Corporation Code expressly provides the general rule that the corporate powers and business of all corporations shall be held and conducted by the board of directors.<sup>72</sup>

The stockholders as owners of the corporation elect the board of directors, with each stockholder entitled to vote, in person or by proxy, proportionate to the number of shares outstanding in the books of the corporation at the time fixed in the by-laws, or, if silent, at the time of the election.<sup>73</sup> Further, each director must own at least one share of stock of the corporation and not be otherwise disqualified by law.<sup>74</sup>

It should also be noted that there are some corporate actions that require the affirmative votes of both stockholders and directors, voting separately, as expressly provided under the Corporation Code.

## h. Finance and Fundraising

A corporation's initial capital is raised through stockholders' investment of cash or property in exchange for shares of stock of the corporation.<sup>75</sup> The corporation may opt to sell its shares of stock to public by becoming publicly-listed or through the conduct of an initial public offering. Investment from stockholders is encouraged by the possibility of earning dividends and the limited liability feature of the corporation.

## i. References

- The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Bilang 68 (1980)
- An Act Amending The National Internal Revenue Code, As Amended, And For Other Purposes [TAX REFORM ACT OF 1997], Republic Act No. 8424 (1997)
- An Act To Promote Foreign Investments, Prescribe The Procedures For Registering Enterprises Doing Business In The Philippines, And For Other Purposes [FOREIGN INVESTMENTS ACT OF 1991], Republic Act No. 7042 (1991)
- SEC Memorandum Circular No. 21, series of 2013
- SEC Memorandum Circular No. 3, series of 2017
- Securities and Exchange Commission
  - » Citizens Manual on Reportorial Requirements, available at <http://www.sec.gov.ph/wp-content/uploads/2015/10/Citizens-Manual-on-Reportorial-Requirements.pdf> [last accessed: 24 November 2017]
  - » Primary Registration of Stock Corporations, available at <http://www.sec.gov.ph/services-2/company-2/registration/primary-registration/stock-corporation-registration/> [last accessed: 25 November 2017]
  - » Company Registration System, available at <https://crs.sec.gov.ph/> [last accessed: 25 November 2017].

<sup>72</sup> Section 23, Corporation Code.

<sup>73</sup> *Id.*, at Section 24.

<sup>74</sup> *Id.*, at Sections 24 and 27.

<sup>75</sup> *Id.*, at Section 62.

- » *Documentary Requirements for Stock Corporation: Cash Payment for Subscription*, available at <http://www.sec.gov.ph/services-2/company-2/registration/primary-registration/stock-corporation-registration/> [last accessed: 24 November 2017]
- » *Businesses Requiring Endorsements From Other Departments of the Commission/Other Government Agencies*, available at <http://www.sec.gov.ph/wp-content/uploads/2015/01/Endorsement-Clearance.pdf> [last accessed: 24 November 2017]
- » *Documentary Requirements for Stock Corporation: Non Cash Payment for Subscription*, available at [http://www.sec.gov.ph/wp-content/uploads/2015/01/Doc\\_Regts\\_Stock\\_Non\\_Cash1.pdf](http://www.sec.gov.ph/wp-content/uploads/2015/01/Doc_Regts_Stock_Non_Cash1.pdf) [last accessed: 24 November 2017]

## B. NON-STOCK CORPORATION

### a. Overview

A non-stock corporation is a corporation with no authorized capital stock and where no part of its income is distributable as dividends to its members, trustees, or officers.<sup>76</sup> It is organized for charitable, religious, educational, professional, cultural, fraternal, literary, scientific, social civil service, or similar purposes, like trade, industry, agricultural and like chambers, or any combinations thereof.<sup>77</sup>

Thus, for a corporation to be considered a non-stock corporation, it is required that (1) its primary purpose is *eleemosynary* in nature, and (2) there is a prohibition in its articles of incorporation and by-laws that no part of its income is distributable through dividends or in any form to its members, trustees, and officers. The only way assets and/or profits of the non-stock corporation will be distributed to its members is when the corporation is thereafter dissolved.<sup>78</sup>

The provisions of the Corporation Code applicable to stock corporations shall generally apply suppletorily to non-stock corporations. However, when there are more specific rules governing non-stock corporations, such specific rules shall prevail.<sup>79</sup>

### b. Advantages and Disadvantages

#### Advantages

- ✓ Income tax exemption of certain non-stock corporations.<sup>80</sup>
- ✓ Foreigners may generally be members, officers, or trustees of non-stock corporations.<sup>81</sup>
- ✓ Juridical entities may be members of non-stock corporations.
- ✓ Unlike stock corporations, there is no need to file a formal application with the SEC to reflect an increase in the contributed capital.
- ✓ Unlike stock corporations, there is no need to have the SEC approve its promulgated rules and regulations.

<sup>76</sup> Section 87, Corporation Code.

<sup>77</sup> *Id.*, at Section 88.

<sup>78</sup> Section 87 in relation to Sections 94 and 95, Corporation Code.

<sup>79</sup> *Id.*, at Section 87.

<sup>80</sup> Section 30, Tax Code.

<sup>81</sup> Subject to the limitations of the Anti-Dummy Law (Commonwealth Act No. 108, as amended) in cases where the non-stock corporation is engaged in nationalized activities.

## Disadvantages

- ✗ Membership is usually personal and non-transferable, unless provided otherwise in the articles of incorporation or by-laws.<sup>82</sup>
- ✗ Generally not empowered to engage in business for profit, except when necessary to carry out the eleemosynary purposes for which it was organized.(

**c. Establishment Process, Documentation, and Costs**

The incorporation procedure for non-stock corporations with the SEC is as follows:<sup>83</sup>

| DURATION      | REQUIREMENT                                                                                    | PROCEDURE                                                                                                                                                                                                    | FEES                                                                       |
|---------------|------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|
| 10 minutes    | Verify or reserve proposed name                                                                | If the proposed name is allowed by the system, a reservation and confirmation notice is printed and given to the applicant.                                                                                  | Php100.00 reservation fee for 30 days                                      |
| 10-20 minutes | Present articles of incorporation and by-laws at GLU                                           | SEC will verify completeness of documentary requirements. If complete, the applicant will be required to pay the filing fee.                                                                                 | Php2,020.00 Registration fee for the articles of incorporation and by-laws |
| 5 minutes     | Pay filing fee at the cashier and file application form with the receiving unit                | After receipt of application, the company registration and monitoring department ("CRMD") of the SEC will generate the certificate of incorporation bearing the applicant's SEC registration number and URR. | None                                                                       |
| 5 minutes     | Present official receipt to releasing unit for the release of the certificate of incorporation | The assistant director of the CRMD will review the application and forward it for approval of the Director.                                                                                                  | None                                                                       |

This procedure requires the following documents:<sup>84</sup>

*Basic Requirements*

1. Name verification slip
2. Articles of incorporation and by-laws
3. Joint affidavit of two incorporators to change corporate name (not required if already stated in articles of incorporation)
4. List of members certified by the corporate secretary, unless already stated in the articles of incorporation
5. List of the names of contributors or donors, and the amounts contributed or donated by each, certified by the treasurer. There is no fixed amount of contribution required but only such reasonable amount as the incorporators and trustees may deem sufficient to enable the corporation to start operation, except in the case of foundations which must have a minimum contribution of at least one million pesos (Php1,000,000.00)

<sup>82</sup> Section 90, Corporation Code.

<sup>83</sup> SEC, *Primary Registration of Non-Stock Corporations*, available at <http://www.sec.gov.ph/services-2/company-2/registration/primary-registration/non-stock-corporation-registration/> [last accessed: 23 November 2017].

<sup>84</sup> SEC, *Documentary Requirements for Non-Stock Corporation*, available at [http://www.sec.gov.ph/wp-content/uploads/2015/01/Doc\\_Reqts\\_NonStock.pdf](http://www.sec.gov.ph/wp-content/uploads/2015/01/Doc_Reqts_NonStock.pdf) [last accessed: 23 November 2017].

*Additional Requirements (When Applicable)*

1. Endorsement/clearance from other government agencies, if applicable.
2. For foundations: notarized certificate of bank deposit of the contribution which shall not be less than One Million Pesos (Php1,000,000.00) and statement of willingness to allow the SEC to conduct an audit.
3. For religious corporations: additional requirements under sections 109-116 of the Corporation Code, and an affidavit of affirmation or verification by the chief priest, rabbi, minister or presiding elder.
4. For federations: certified list of member-associations by corporate secretary or president.
5. For condominium corporations/associations: master deed and declaration of restrictions with primary entry of the register of deeds, and certification that there is no other existing similar condominium association within the condominium project.

**d. Liabilities**

The provisions on limited liability of stock corporations discussed above are likewise applicable to non-stock corporations. A non-stock corporation has a separate juridical personality and can therefore sue and be sued in its own capacity.<sup>85</sup>

**e. Tax treatment**

Generally, the income of non-stock corporations is taxed the same way as stock corporations. However, some non-stock, non-profit corporations enjoy tax exemptions such as those covered under section 30(e) of the Tax Code which provides:

“Non-stock corporation or association organized and operated exclusively for religious, charitable, scientific, athletic, or cultural purposes, or for the rehabilitation of veterans, no part of its net income or asset shall belong to or inure to the benefit of any member, organizer, officer or any specified person.”

The guidelines for the application for and processing of tax exemption rulings to qualified non-stock, non-profit corporations and associations under section 30 of the Tax Code are set forth in BIR Revenue Memorandum Order No. 20-2013.<sup>86</sup>

**f. Prevailing Regulations and Reportorial Requirements**

The SEC imposes the same minimum reportorial requirements on non-stock corporations as it imposes on stock corporations, discussed above. Hence, non-stock corporations must also submit an annual GIS and AFS.

However, as will be discussed in more detail below, foundations notably have additional reportorial requirements.

<sup>85</sup> Section 36, Corporation Code.

<sup>86</sup> It should be noted that only non-stock, non-profit *educational* institutions are exempted from complying with the requirements under BIR Revenue Memorandum Order No. 20-2013 by virtue of the Supreme Court ruling in *Henares vs. St. Paul College of Makati*, G.R. No. 215383 (2017).

### g. Corporate Structure

Participation in non-stock, non-profit corporations is mainly for eleemosynary purposes. Membership is therefore purely personal in character and may be terminated for causes stated in the articles of incorporation and by-laws.<sup>87</sup>

### h. Governance

Non-stock corporations are governed by a board of trustees elected via straight voting of all its members. Cumulative voting may apply when permitted under the articles of incorporation or by-laws. Officers of a non-stock corporation may be directly elected by the members, unless otherwise provided in the articles of incorporation or the by-laws.<sup>88</sup>

Juridical persons may be members of the board of trustees. Foreigners may also be members or officers of a non-stock corporation, except for the position of corporate secretary.

A non-stock corporation may adopt rules and regulations without SEC approval, provided they are not contrary to law, or its articles of incorporation and by-laws.

### i. Finance and Fundraising

Aside from the amounts covering subscription to membership rights, a non-stock corporation may collect membership dues. The manner of assessment and collection should be in accordance with the articles of incorporation and by-laws. In the absence of such provisions, the corporation may still collect membership dues but only when it is reasonable and only for purposes of accomplishing the purposes or objectives for which the corporation was organized.

A non-stock corporation may also engage in fundraising activities, but only if it is necessary to carry out the purposes for which it was organized. Such fundraising activities may be conducted provided the pertinent laws and administrative regulations applicable to such activity, if any, are complied with.

Capital contributions may be increased by the non-stock corporation without the express approval of the SEC. It is sufficient that the AFS submitted by the non-stock corporation accurately reflects the same.

### j. Case Study

Hybrid Social Solutions Inc. ("HSSI") is a social business which partners with villagers who have no access to electricity in order to harness the sun to climb out of poverty. It operates in rural municipalities nationwide through "Solar Hubs" which distribute and service innovative solar-powered solutions that improve quality of life, livelihood, and access to social services.

HSSI is a line of solar home appliances that enable users to harness the power of the sun to meet their everyday needs, such as lamps, lights, mobile phone chargers, power boxes and other low-power DC home devices - each manufactured from durable materials to ensure long-term use.

Its mission is to provide all communities with continuous access to high-quality goods and services for basic development by building "hybrid value chains" with like-minded partners.

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<sup>87</sup> Sections 90 and 91, Corporation Code.

<sup>88</sup> *Id.*, at Section 92.

Its vision is to end poverty and spur development by enabling all communities to access basic development-oriented goods and services.

HSSi also created the Solar Energy Foundation Network for Rural Development, in partnership with SunTransfer, which allows its member organizations in Kenya, Ethiopia, and the Philippines to negotiate with suppliers and obtain exclusive distribution rights for certain products, allowing it to reduce prices.

HSSi's livelihood applications have been found to increase the household cash flow of its customers by 25%, while dramatically improving health and safety conditions by eliminating kerosene fumes, fires and accidental ingestion.

## k. References

- The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Bilang 68 (1980)
- An Act Amending The National Internal Revenue Code, As Amended, And For Other Purposes [TAX REFORM ACT OF 1997], Republic Act No. 8424 (1997)
- **Henares vs. St. Paul College of Makati**, G.R. No. 215383 (2017)
- Securities and Exchange Commission
  - » *Primary Registration of Non-Stock Corporations*, available at <http://www.sec.gov.ph/services-2/company-2/registration/primary-registration/non-stock-corporation-registration/> [last accessed: 23 November 2017]
  - » *Documentary Requirements for Non-Stock Corporation*, available at [http://www.sec.gov.ph/wp-content/uploads/2015/01/Doc\\_Regts\\_NonStock.pdf](http://www.sec.gov.ph/wp-content/uploads/2015/01/Doc_Regts_NonStock.pdf) [last accessed: 23 November 2017]
  - » *Reportorial Requirements for Corporations with Primary Licenses*, available at <http://www.sec.gov.ph/reportorial-requirements/corporations-with-primary-licenses-2/> [last accessed: 24 July 2017]
- World Bank, *Starting a Business in the Philippines*, available at <http://www.doingbusiness.org/data/exploreeconomies/philippines/starting-a-business> [last accessed: 24 July 2017].i.



## FOUNDATIONS

### a. Overview

An SEC-registered “foundation” is a non-stock, non-profit corporation established for the purpose of extending grants or endowments to support its goals, or raising funds to accomplish charitable, religious, educational, athletic, cultural, literary, scientific, social welfare, or other similar objectives.<sup>89</sup>

Currently, there are foundations in the Philippines which support social enterprises. For example, the **Foundation for a Sustainable Society (“FSSI”)** is a social investment organization committed to providing financial services and grants, support enhancements for entrepreneurial capacities, and policy support to social enterprises.<sup>90</sup> FSSI is not a social enterprise itself but it contributes directly to the development of other social enterprises. It has a social enterprise fund to invest in social enterprises, provide trainings for them, and lobby for their advocacies to government on their behalf.<sup>91</sup>

Another notable example is the **Gawad Kalinga Community Development Foundation, Inc. (“GK”)**, a Philippine-based movement that aims to end poverty for 5 million families. GK’s work began as early as 1994 in its efforts to alleviate the poor conditions in Bagong Silang, Caloocan City, one of the biggest relocation sites of informal settlers in Metro Manila. GK was formally established in 2003 and has since expanded its work to over 2,000 organized communities. The GK practice has in fact been adopted in other developing nations like Cambodia, Indonesia and Papua New Guinea. GK is also currently at the forefront of peace-building initiatives in conflict areas in Mindanao and reconstruction work in post-disaster areas.<sup>92</sup>

### b. Advantages and Disadvantages

#### Advantages

- ✓ Tax exempt<sup>93</sup>
- ✓ Donations, contributions and gifts to foundations are deductible expenses for the donor<sup>94</sup>
- ✓ Minimum contributed capital is only Php1,000,000.00<sup>95</sup>

#### Disadvantages

- ✗ Administrative expenses should not exceed 30% of the total expenses<sup>96</sup>
- ✗ In the event of dissolution, its net assets should be distributed to another non-profit corporation organized for similar purposes, or to the State.<sup>97</sup>
- ✗ Greater reportorial obligations to the BIR compared to regular non-stock corporations.
- ✗ Prohibition on distributing profits to members.<sup>98</sup>
- ✗ Heavily dependent on donations, contributions and/or gifts.

<sup>89</sup> Section 1, SEC Memorandum Circular No. 8, series of 2006 (“SEC MC No. 8”).

<sup>90</sup> FSSI, *How We Help*, available at <http://www.fssi.com.ph/what-we-do/how-we-help/> [last accessed: 23 November 2017].

<sup>91</sup> FSSI, *About the Organization*, available at <https://www.choosesocial.ph/organization/foundation-for-a-sustainable-society-fssi> [last accessed: July 24, 2017].

<sup>92</sup> Gawad Kalinga Foundation, *Who We Are*, available at <http://www.gkiworld.com/our-journey> [last accessed: 24 July 2017].

<sup>93</sup> Section 30, Tax Code.

<sup>94</sup> *Id.*, at Section 34(H).

<sup>95</sup> Section 2, SEC MC No. 8.

<sup>96</sup> Section 34(H), Tax Code.

<sup>97</sup> Sections 94 and 95, Corporation Code.

<sup>98</sup> *Id.*, at Section 87.

### c. Establishment Process, Documentation, and Costs

The registration process for foundations is the same as non-stock corporations. However, it should be noted that it is mandatory a foundation to include the word “Foundation” in its corporate name.<sup>99</sup>

In addition to registration requirement imposed on non-stock corporations as discussed above, the SEC provides the following requirements for foundations:

1. Notarized Certificate of Bank Deposit of the amount of not less than One Million Pesos (Php1,000,000.00) and;
2. Statement of willingness to allow the SEC to conduct an audit.<sup>100</sup>

### d. Liabilities

The provisions on limited liability of stock and non-stock corporations discussed above are likewise applicable to foundations. A foundation has a separate juridical personality and can therefore sue and be sued in its own capacity.<sup>101</sup>

### e. Tax Treatment

Foundations enjoy tax-exempt status under section 30 of the Tax Code in accordance with the same conditions discussed above.

Further, donors enjoy tax privileges when giving donations, contributions and/or gifts to qualified foundations. According to the Tax Code, contributions and gifts made to foundations may be deductible in full by the donor from his taxable gross income.<sup>102</sup> This tax feature serves as a great motivation for more donors to extend aid to foundations to accomplish their laudable advocacies.

For donations to a foundation to qualify for full tax-deduction, BIR-NEDA Regulations No. 1-81 requires donee foundations to file a sworn statement with the government and Tax Exempt Corporation Division of the BIR indicating (1) the character of the foundation; (2) the purpose for which it is organized; (3) its actual activities; (4) the sources of income and its dispositions; and (5) other facts relating to their operations which are relevant to their qualification as donee institutions.

### f. Governance and Regulatory Obligations

In addition to the GIS and AFS, foundations are required to submit the following:

1. A sworn statement by its president and treasurer on the following information relating to the preceding fiscal year:
  - a. Source and amount of funds;
  - b. Program/activity planned, ongoing and accomplished:
    - i. Corporate name, address and contact number of the project officer-in-charge;
    - ii. Complete address and contact number of project office; and

<sup>99</sup>. Section 3, SEC MC No. 8.

<sup>100</sup>. Section 2, SEC MC No. 8.

<sup>101</sup>. Section 36, Corporation Code.

<sup>102</sup>. Section 34(H)(2)(c), Tax Code.

- c. Application of funds.<sup>103</sup>
- 2. Certification from the office of the mayor, the office of the barangay captain, or the head of either the Department of Social Welfare and Development or Department of Health, on the existence of the subject project/activity in the locality over which it exercises jurisdiction.<sup>104</sup>

#### *BIR Reportorial Requirements*

##### A. A Tax Exemption Ruling

is valid for a period of three years. For a foundation to maintain its status as a tax-exempt entity, it should file a subsequent application for tax exemption/revalidation, under the same requirements and procedures provided in BIR Revenue Memorandum Order No. 20-2013. Otherwise, the exemption shall be deemed revoked upon the expiration of the tax exemption ruling. The new tax exemption ruling shall be valid for another three years, unless revoked or cancelled sooner.<sup>105</sup>

##### B. Donee Institution Requirements

A foundation, to maintain its status as a qualified donee institution, must file its annual information return by the fifteenth day of the fourth month after the close of its taxable year.<sup>106</sup> The annual information return should be certified by an officer of the company, and contain the following:

- 1. List of activities and/or projects undertaken by the institution;
- 2. Cost of each undertaking indicating in particular where and how the donation has been utilized; and
- 3. That no part of its net income inures to the benefit of any private stockholder or individual.

#### **g. Governance**

There is no prohibition against foreigners sitting on the board of directors of foundations.

#### **h. Finance and Fundraising**

As previously discussed, a foundation seeking registration must have a minimum capitalization of Php1,000,000.00.

Foundations may engage in fundraising activities to support their primary purposes. However, as discussed, any profits made will be subject to income tax. Also, as discussed, a foundation's net profits should revert to the primary purposes of the foundation and none should inure to the benefit of any private entity or individual.

Also, the Tax Code provides that donations, contributions and/or gifts to donee institutions are deductible in full. This attractive feature proves to be a motivation for taxpayers to donate and contribute to foundations because of the greater tax benefit to them.

<sup>103</sup>. Section 4, SEC MC No. 8.

<sup>104</sup>. Section 5, SEC MC. No. 8.

<sup>105</sup>. BIR Revenue Memorandum Order No. 20-2013.

<sup>106</sup>. Section 7, BIR Revenue Regulations No. 13-98.

## i. References

- The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Bilang 68 (1980)
- An Act Amending The National Internal Revenue Code, As Amended, And For Other Purposes [TAX REFORM ACT OF 1997], Republic Act No. 8424 (1997)
- SEC Memorandum Circular No. 8, series of 2006
- BIR Revenue Regulations No. 13-98
- BIR Revenue Memorandum Order No. 20-2013
- FSSI, *How We Help*, available at <http://www.fssi.com.ph/what-we-do/how-we-help/> [last accessed: 23 November 2017]
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- Gawad Kalinga Foundation, *Who We Are*, available at <http://www.gklworld.com/our-journey> [last accessed: 24 July 2017]

## CONCLUDING REMARKS

The social enterprise sector in the Philippines is ripe and ready for growth. The country is on the cusp of important policy changes that could see social enterprises start to have much wider presence and impact in the coming years. Ensuring that legislation is in place to recognize social enterprises and provide forms of support will be crucial to the implementation of any legislation that will be passed.

Institutionalizing a workable legal definition of “social enterprise” will be fundamental to securing practical and viable legislation. The definition needs to be acceptable to all the stakeholders involved both in the private and public sector. It also needs to be measurable and consistent with the principles of accountability and transparency.

Awareness for social enterprises is also growing. Social enterprises and support organizations can further increase this awareness and the growth of the social enterprise sector by promoting their business models, operations, and philosophies to the public. The Philippines is likewise monitoring and studying the development of social enterprises. It is important to ensure that this research is diverse and rigorous, and disseminated to the public through online publications and other outlets beyond tertiary education institutions.

# THAILAND





# THAILAND

## INTRODUCTION

For some years now, the Thai government has had a policy of promoting social enterprises to improve the quality of life of the Thai people and enable the private sector to work with the government to help communities and the broader society.

The concept of a social enterprise has been present in Thailand for several years and is defined in the Regulations of the Office of the Prime Minister for National Promotion of Social Enterprises B.E 2554 (2011) as “an act of a private sector, which is a person, a group of persons, or a community, operating or carrying out businesses with initially the express purpose of addressing problems and developing a community, society or environment, and generating revenue by selling goods or providing services not with the primary objective of maximizing profit for its shareholders.” Social enterprises have the following specific attributes:

- Undertaking manufacturing or other operations which do not adversely affect health, society, and the environment in the long-term;
- Applying a doctrine of self-sufficiency;
- Having the potential to have its own financial stability;
- Accumulating revenue principally from businesses or operations carried out, in order to further a purpose of addressing problems and developing communities, societies, or the environment, or returning benefits to society;
- Possessing the capacity to be in a variety of organizational forms; and
- Exercising good governance.

From 2011 to 2017, the Thai government has actively and continually engaged in social enterprise reform and promotion. The National Reform Council (NRC) is the responsible body for reforming social enterprise law in Thailand, tasked with studying and recommending legislative action, and setting the vision and future direction of Thailand for the next 20 years.

The NRC has been setting agendas and is considering all inputs about social enterprise from experts and the general public. The NRC is currently pursuing the following agendas, intended to contribute to a well-developed social enterprise ecosystem in which social enterprises are independent and self-sustainable, and not heavily reliant on government funding or private donations:

- Social entrepreneurship education
  - Social innovation research system
  - Social enterprise (SE) start-up grant program
-

- SE certification system
- SE legal reform
- SE fund
- Sustainable procurement program
- Tax relief for social enterprises and social investors
- Thai social enterprise board/office/association

The Royal Decree on Tax Exemption (No. 621) B.E. 2559 in 2016, provide tax incentives for businesses that fall under the definition of a social enterprise, as long as they meet certain qualifications, as well as for investors and donors who contribute to social enterprises.

To fall within the Royal Decree's definition of a "social enterprise," a business must:

- be established under Thai law, with the objectives of operating a business for the sale of goods or provision of services;
- aim to promote employment at the location of its social enterprise, or solve problems or develop local communities, societies, or the environment; and
- not emphasize maximizing profits for shareholders or partners, and invest at least 70 percent of its profits back into the business, or for the benefit of farmers, the poor, the disabled or the disadvantaged, or other causes prescribed by the Minister of Finance.

Although a business may fall under the definition of a social enterprise, to qualify for corporate income tax exemption on its net profits, 100 percent of its profits must be invested in the business, or used for the benefits of the groups above, or other common benefits, in accordance with the rules, procedures, and conditions prescribed by the director-general of the Revenue Department (the "Director-General").

To be eligible for corporate income tax exemption, a social enterprise must also:

- include the words "social enterprise" in its name;
  - be certified as a social enterprise by an agency prescribed by the Director-General;
  - successfully apply to the Director-General to be a social enterprise on the prescribed form;
  - not pay assessable income (dividends, share of profits, or income from capital reduction) to shareholders or partners;
  - not transfer property used in the business except as prescribed by the Director-General;
  - not be a contracting party of its shareholders or partners, and there must be no payment of any remuneration to its shareholders or partners, including related persons of shareholders or partners, except where prescribed by the Director-General;
  - not change the form of business operation from a social enterprise to another type of business before the lapse of ten accounting periods, starting from the accounting period when the business was approved to be a social enterprise; and
  - comply with other rules, procedures, and conditions prescribed by the Director-General.
-

If a social enterprise does not comply with the specified conditions, its tax privileges are revoked from the beginning.

In addition, companies and juristic partnerships investing in social enterprises can enjoy corporate income tax exemption of 100 percent of the amount invested in the social enterprise, provided that the social enterprise meets all of the requirements specified above, with the exception that the social enterprise can pay a maximum of 30 percent of its profits in dividends, share of profits, or capital reduction. Failure to meet this condition will result in loss of tax exemption for the investors. Similarly, if an investor transfers shares in the social enterprise prior to its dissolution, the investor would lose the tax exemption.

Companies and juristic partnerships donating money or property to a social enterprise can enjoy corporate income tax exemption of up to 2 percent of their net profit, provided that the social enterprise meets all of the conditions specified above, with the exception that the social enterprise can pay a maximum of 30 percent of its profits in dividends, share of profits, or capital reduction. In considering the 2 percent cap, donations to social enterprises must be included in aggregate with other qualified charitable donations. Failure to meet the foregoing will result in loss of tax exemption for the donors.

Social enterprises that seek to conduct fundraising activities must ensure compliance with the Fundraising Control Act B.E. 2487 (1944), which is the applicable law governing fundraising, a regulated and licensed activity in Thailand.

Under the law, fundraising includes any purchase, sale, exchange, compensation or service which can be shown to be for a charitable (rather than business) purpose, either for contribution to a local government or for public interests. Fundraising activities can be conducted in public places or public advertisements.

Fundraising can only occur if the Fundraising Control Council (FCC) has approved it, except where:

- consent for fundraising has been given by the relevant ministry, government bureau, or department arrangement; or
- fundraising is for a public charity during a religious activity, etc.; or
- fundraising during a permitted trade fair (selling goods).

The following fundraising activities are prohibited:

- Collecting funds to compensate a defendant for the payment of fines for a legal violation (unless collected from the defendant's relatives)
  - Specifying the amount of money or other assets that a donor must donate
  - Damaging public order or morale
  - Damaging the diplomatic relations between Thailand and other foreign countries;
  - Funding other countries' weapons procurement
  - Forcing a person to donate, or causing any fear or apprehension to a person (i.e., threatening a person if they don't donate money to a cause)
-



A fundraiser must:

- hold a valid fundraising license at all times;
- issue a receipt to the donor upon receipt of money or assets, and keep the copy of the receipt as evidence; and
- not use raised funds for any purpose other than the objective of the organization stated to the FCC, except for reasonable expenses.

People are prohibited from working as fundraisers if they:

- are less than 16 years of age;
- are subject to mental disability;
- have a contagious disease;
- have been convicted of a criminal offence of robbery (theft), armed robbery, aggravated robbery, piracy, extortion, fraud, embezzlement, receiving stolen property, or corruption within the last five years; or
- are considered to be unsuitable to perform a fundraising role by an FCC officer.

To support an application for a fundraising license, a partnership's managing partner or authorized legal representative must provide the following documents:

- A copy of the certificate of registration of the partnership
- A copy of the partnership's balance sheet for the last two years, certified by an auditor
- A photograph of the fundraiser (size 6x4 cm) taken within the past six months
- A copy of the fundraiser's personal identification card or passport
- A copy of the fundraiser's household registration
- Two copies of the fundraising statement (translated into Thai) which will be used in the fundraising activities
- A copy of any past fundraising license(s)
- Evidence of past performance, e.g., past fundraising performance report, or a balance sheet for income and expenses, if any
- A copy of the bank book for the account to which the amount raised will be transferred
- A certificate of good behavior from a credible source
- A map of the office location and a picture
- Letter of permission from the owner of the office (if the office is leased)
- A medical certificate of the fundraiser's health

It takes approximately 60 days for the license to be issued by a responsible authority. The Department of Provincial Administration, Ministry of Interior, is the applicable authority for Bangkok, with district officers responsible for other provinces. There is no applicable fee.

## Foreign Business Restrictions

Social entrepreneurs seeking to set up social enterprises in Thailand should be aware of the Foreign Business Act B.E. 2543 (2000), which restricts foreign ownership of companies whose operations involve certain types of businesses. A company is considered foreign-owned if 50 percent or more of its shares are owned by non-Thai nationals or foreign companies. In order to operate a company that falls under the restricted activities listed under the Foreign Business Act, a company must obtain a foreign business license or foreign business certificate from the Ministry of Commerce. This applies to for-profit structures, such as companies and partnerships, but not to non-profit structures, such as associations and foundations.

## Future Developments

The Social Enterprise Promotion Bill was drafted to support social enterprises and remains pending. If enacted, the bill would establish a National Social Enterprise Committee, a National Social Enterprise Office, and a Social Enterprise Fund. The National Social Enterprise Office would be an independent state agency with the responsibility of providing support services and training for social enterprises.

The bill would also set new definitions and promotion measures for social enterprises, including registration processes for social enterprises, and would make using the title “social enterprise” by unregistered businesses a fineable offense. It would set out other measures to support and incentivize investments in social enterprises, including loan privileges and knowledge support and training by the National Social Enterprise Office.

Although further changes may be introduced to the bill before it is passed into law, this law has the potential to provide Thailand with a fully-fledged legal framework for the effective establishment, promotion, and regulation of social enterprises.

In the next section, we will explore the various legal forms available to social enterprises in Thailand, and the implications associated with each structure. The legal structures for social enterprises in Thailand include:

- Non-registered ordinary partnership and limited partnership
- Private limited company
- Public limited company
- Association
- Foundation
- Cooperative
- Registered community enterprise / network

## LEGAL STRUCTURE 1 –NON-REGISTERED ORDINARY PARTNERSHIP AND LIMITED PARTNERSHIP

### a. Overview

#### NON-REGISTERED ORDINARY PARTNERSHIP

In a non-registered ordinary partnership, there are three options for governance:

1. Each partner is a managing partner and is able to act on behalf of the partnership
2. The partners can agree to make decisions based on one vote per partner
3. A sole managing partner can be appointed

A non-registered ordinary partnership has joint and unlimited liability. This means that all partners are jointly liable, and they cannot limit their liability to their contributions to the partnership. Partner contributions can be in the form of money, properties, or services.

A non-registered ordinary partnership does not have its liabilities protected even if it registers with the Department of Business Development. Therefore, if any disputes arise between partners, the particular liabilities of each partner will be decided in court. As such, the lack of protection against the partnership's liabilities can make this particular structure unattractive to investors and other individuals who would otherwise be interested in supporting a social enterprise.

#### LIMITED PARTNERSHIP

A limited partnership is a registered legal entity with rights that are separate from its partners. There are two types of partners in this kind of entity:

- A limited partner whose liabilities are limited to their contributions
- A general partner with joint and unlimited liability for all partnership obligations

A limited partnership must be registered in order to establish itself as a separate legal entity.

### b. Advantages & disadvantages

#### Advantages

- ✓ Registration will lead to a separate legal identity, with certain liabilities limited for partners, unlike in a non-registered partnership.
- ✓ May qualify for social enterprise promotion tax exemptions under the Royal Decree on the Exemption of Tax and Duties for Social Enterprises (B.E. 2559), if requirements are met.

#### Disadvantages

- ✗ Lack ability to attract equity capital.
- ✗ Liabilities of directors cannot be completely limited.

Business expansion for social missions may not be possible due to limitations on capital.

### c. Establishment process, documentation & costs

After the partners have agreed on important matters related to the partnership, such as investment options and objectives, they must request to enter the Department of Business Development (DBD) database to search for partnership name availability and to reserve a name, and to check that no registered partnership has already registered under the same name or a similar name.

After reserving the partnership name, an application for registration can be made. The following documents are required for registration:

- Hor. Sor. 1 and 2
  - Wor. – Detailed objectives
  - Certificate of registered partnership
  - Partnership reservation notification
  - Application to use a foreign name
  - Sor. Sor. Chor. 1
  - Map of the head office and surrounding area
  - Consent letter to use the address of the head office, along with the title of ownership or possessory right (e.g., a land deed, or lease agreement – original copies must be reviewed by authorities, and photocopies submitted)
  - Evidence of received payment, for payments from the partnership to partners
  - Copies of evidence issued by a bank to guarantee, or show the financial status of all the Thai partners
  - Evidence issued by the bank to guarantee or show that the managing partner has received the investment from other partners, as well as the original copies of documents proving that payments received by the managing partner have been received by the partnership
  - Consent letter from the owner of assets to transfer ownership to the partnership, and give them the right to use the assets
  - Evidence that the partnership has possessory rights over assets
  - Copies of accounts demonstrating the value of the assets which have been invested
  - Contract for the transfer of assets (original)
  - Power of attorney (if any)
  - Evidence of charges paid
  - Personal identification of all the partners
  - Evidence of notary services (if any)
-

If all the documents are correct and present, the total application process will take about one day. However, if the documents are incorrect, or if there are any other issues with the application, the process can take up to one month. The application process is as follows:

1. The application form is to be filled out, using either a typewriter or a computer, and then printed out.
2. The managing partner must sign every page of the application form in the presence of:
  - the registrar;
  - administration staff;
  - senior police officers from the province where the managing partner is registered;
  - ordinary or extraordinary members of the Bar Association;
  - a qualified auditor; or,
  - any individual listed in regulations issued by the Central Registration Office.

If the managing partner signs the application form outside Thailand, it must be done in front of a Thai Embassy officer, the head of that country's office or ministry of commerce or their assigned official, or a notary public. The managing partner's signature must also be validated according to the laws of that country. Two reliable individuals must verify the signature in front of the registrar, in order to confirm its validity.

3. The application is submitted physically by the applicant or agent, or submitted online for an initial check that all the documents are correct before being printed out, signed and submitted. Online applications are retained on the DBD system for two months.

The registration fee is calculated at THB 100 per THB 100,000 of the partnership's assets.

#### **d. Liabilities**

Limited partners are liable in proportion to their contributions to the partnership. General partners have unlimited liability for all obligations of the partnership.

#### **e. Tax treatment**

Limited partnerships are considered juristic partnerships under the Thai Revenue Code and are subject to corporate income tax, which is currently imposed at the rate of 20 percent of net profits. A limited partnership that registers as a social enterprise and meets certain qualifications may enjoy additional corporate income tax exemptions, as discussed in this chapter's introduction.

In addition, limited partnerships investing in social enterprises can enjoy corporate income tax exemption of 100 percent of the amount invested in the social enterprise, provided that the social enterprise meets a number of conditions.

#### **f. Ongoing governance and regulatory obligations**

A Thai majority-owned partnership, which is defined as a partnership with two Thai natural or juristic persons for every foreign partner, can engage in all forms of business. However, partnerships which have a foreigner as the managing partner, or as the manager, or in which the foreigners' investments amount to more than 50 percent of the total partnership capital, will be regarded as a foreign partnership and subject to the Foreign Business Act.

The Foreign Business Act B.E. 2543 (2000) is applicable to the for-profit structure of a limited partnership.

The partnership structure generally does not conform to the needs of most foreign investors, including those seeking to operate a social enterprise. The Thai Board of Investment does not promote partnerships, because businesses of this sort often conflict with the Foreign Business Act. Furthermore, changes in ownership and control may jeopardize the good standing of a partnership or its license.

#### **g. Corporate structure**

A limited partnership may only be managed by general partners who have unlimited liability. Limited partners may only contribute capital or valued properties. If a limited partner takes on a managing role, they will also be subjected to unlimited liability for the partnership's obligations, despite their status as a limited partner.

#### **h. Governance**

A partnership can have a foreigner as the managing partner or as the manager. However, this will be regarded as a foreign partnership and subject to the Foreign Business Act.

#### **i. Finance & fundraising**

Contributions made to a limited partnership by the partners must be either cash or property (not services). Partnerships cannot issue shares to raise funds from the public, and must therefore utilize personal contributions or fundraising if they wish to finance a social enterprise.

Under the law, fundraising includes any purchase, sale, exchange, compensation or service directly or indirectly shown to be for a charitable purpose, rather than normal commercial purposes, but rather, such fund collection is for a charitable purpose, either for contribution to a local government or for public interests. It is permissible for fundraising activities to be conducted in public places or public advertisements.

Fundraising can only occur after the Fundraising Control Council (FCC) has approved the social enterprise's fundraising application. A fundraiser must meet:

- hold a valid fundraising license at all times;
- issue receipts to donors upon receiving money or assets, and keep a copy of the receipt as evidence; and
- not use raised funds for any purpose other than the organization's objective stated to the FCC except for reasonable expenses.

Foreigners are not prohibited from engaging in fundraising so long as they meet all legal requirements. Additional details on fundraising are mentioned in the INTRODUCTION of this chapter.

## j. Case Study 1

### Current Energy Limited Partnership (Asia Pacific Renewable Energy Foundation)

Current Energy has the aim of changing society for the better through environmental activities, specifically offering alternative energy products to both state and private entities, as well as the general public. Profits obtained from sale of the products are contributed to the foundation and used to develop social activities, such as setting up a training center for locals to learn about alternative energy and systems for producing alternative energy. Current Energy aims to help locals become self-reliant and to allow them to use their training to create jobs or alternative energy-related products themselves as a form of livelihood.

The company's products include biogas producers, electricity generators, solar-powered water pumps, and solar panels. Current Energy operates a social needs business model, which emphasizes social impact through processes, and products and services which are environmentally friendly, using fair-trade methods.

## k. Resources

- [www.boi.go.th/index.php?page=types\\_of\\_business\\_organizations\\_01\\_partnerships](http://www.boi.go.th/index.php?page=types_of_business_organizations_01_partnerships)
  - [www.dbd.go.th/dbdweb\\_en/ewt\\_news.php?nid=3973&filename=index](http://www.dbd.go.th/dbdweb_en/ewt_news.php?nid=3973&filename=index)
-

## LEGAL STRUCTURE 2 – PRIVATE LIMITED COMPANY

### a. Overview

A private limited company is a registered legal entity which is considered a juristic person. Limited companies are formed by three or more persons subscribing their names to a memorandum, which seek to make profits. A private limited company's capital is split into equally valued shares, where shareholders' liability is limited to the unpaid value on their own shares.

### b. Advantages & disadvantages

#### Advantages

- ✓ Liability of shareholders is limited to the amount unpaid on the shares held by them.
- ✓ Less regulation means more flexibility in raising capital, such as by selling shares.
- ✓ Ability to distribute dividends or other benefits to shareholders and employees. Flexibility in social activities and purposes. Social purposes can be incorporated in shareholder agreements and the company's objectives.
- ✓ May qualify for social enterprise promotion tax exemptions under the Royal Decree on Tax Exemption (No. 621) B.E. 2559, if requirements are met.

#### Disadvantages

- ✗ Difficulty in permanently fixing social objectives, as objectives may be changed later if the company is acquired or dissolved.
- ✗ Difficulty in balancing profits and social benefits.
- ✗ Difficulty in branding due to dual purpose, and possibly unclear aims, of company.
- ✗ Private profit motive may take a higher priority than social aims.

### c. Establishment process, documentation & costs

The application and registration process of a limited company is as follows:

1. Reserve a name with the Department of Business Development.
2. File the company's memorandum of association (MOA), with at least three promoters named. The fee for filing an MOA is THB 500 THB per THB 1 million of registered capital, with a minimum fee of THB 500 and a maximum fee of THB 25,000. The process can take approximately two to three working days.
3. Fully subscribe in shares.
4. Call a meeting of share subscribers in order to formally establish the company. The meeting should cover the articles of association, appointment of directors, the setting of the director's powers and duties, and the appointment of auditors.
5. Conduct payment for shares. Share payment must not be less than 25 percent of their nominal amount.



6. Promoters will hand over the business to the directors, who will apply for registration of the company as a separate legal entity. The government fee for this is THB 5,000 per THB 1 million of registered capital. The minimum fee is THB 5,000, and the maximum fee is THB 250,000. The process takes approximately four to five working days. However, if all the requirements are met, the company can be registered within one day.
7. Once the registration is approved by the registrar, a certificate of incorporation will be sent to the company. The company's registration number will be its company tax identification number.

If the company expects to earn THB 1.8 million, it must acquire a VAT certificate from the Revenue Department. This process should take three to five days.

#### **d. Liabilities**

A private limited company is a juristic person, which means it is a separate legal entity with its own separate obligations. Therefore, its liabilities are separate from its shareholders, who are not personally at risk under the company's obligations. Shareholder liability is limited to the unpaid share price owed to the company. Limited liability encourages investment by shareholders, which allows for the company to raise more capital for social purposes.

#### **e. Tax treatment**

Corporate income tax in Thailand is generally imposed at the rate of 20 percent of net profit. Subject to conditions, exemption and/or reduction of corporate income tax is granted to small and medium enterprises (SMEs), regional operating headquarters, international headquarters, and international trade centers.

A private limited company that registers as a social enterprise and meets certain qualifications may enjoy additional corporate income tax exemption under the Royal Decree on Tax Exemption (No. 621) B.E. 2559 if the business meets a number of conditions mentioned in the INTRODUCTION of this chapter.

In addition, companies investing in social enterprises can enjoy corporate income tax exemption of 100 percent of the amount invested in the social enterprise, provided that the social enterprise meets a number of conditions.

#### **f. Ongoing governance and regulatory obligations**

The objectives of the company must be submitted with its MOA, which is a corporate document that provides the company's objectives and other details. The company's objectives must set out its social purposes, and how to resolve conflicts between its profit-making and social aims. The company must act within its stated objectives.

The company's articles of association (AOA), however, address the company's rules internally. A company's AOA can include the rights and responsibilities of the directors and shareholders, including setting a provision that directors must promote social aims. The AOA can also allocate company assets for social aims.

The MOA and the AOA are considered together, and must comply with the principles of contract law. They may be changed through a special shareholder resolution by at least three-fourths of the votes of eligible shareholders. This means that social purposes cannot be permanently fixed within the company's objectives, and a limited company may change its objectives to be purely profit seeking.

The Foreign Business Act B.E. 2543 (2000) is applicable to the for-profit structure of a private limited company.

### g. Corporate structure

Two types of management are used together to govern a private limited company:

- **Direct management** by the company directors who are appointed by shareholders to manage and represent the company, as its agents, conducting activities.
- **Indirect management** by the resolutions of shareholders at general or special meetings. Shareholders may restrict directors' powers or remove them at any point through a general resolution. Major decisions such as increasing capital may only be made by a special resolution, which must be passed by at least three-fourths of the votes at a shareholders meeting.

At every annual shareholders' meeting, one-third of the directors must retire, unless otherwise set out in the company AOA. However, the retired directors may be re-elected.

### h. Governance

A foreigner is able to be the sole director and manage the business without being subject to the restrictions of the Foreign Business Act so long as their shares in the company do not exceed 49 percent. Shares can be structured to confer the foreign director with preferred shares, which provides more voting rights and voting power over Thai shareholders, even though Thai shareholders must still maintain 51 percent of total shares.

### i. Finance & fundraising

A private limited company splits its capital into a number of shares, which are subscribed to by shareholders. Each share usually has a low value, and shareholders will hold numerous shares each. In order to raise more capital, including to finance a social enterprise, a company may split its shares into smaller portions and sell more shares to new subscribers. Shares cannot be withdrawn as they are permanent capital, but shareholders can freely transfer shares without restrictions. Private limited companies cannot issue shares to raise funds from the public.

Private limited companies may also utilize personal contributions or fundraising to finance a social enterprise. Foreigners are not prohibited from engaging in fundraising so long as they meet all legal requirements, including those of the fundraising control act. Additional details on fundraising are mentioned in the INTRODUCTION of this chapter.

### j. Case Study 2

#### Social Motion Limited (Social Giver)

Social Giver is an online platform for donations to social organizations. The platform sets quotas for products or services from businesses in hospitality, including hotels and restaurants. Users of the platform can make donations to various social organizations and receive vouchers that can be redeemed for these products or services.

Their process is as follows:

- Social Giver propose their social enterprise concept to hospitality businesses.
- The hospitality businesses offer deals on products or services without charging a price. The owner of the business will set the best available price on the deal.

- The profile of participating businesses will be posted on the platform, and their deals opened for purchase by anyone.
- Users of the platform buy deals, choosing which organization they will send their donations to, and receive a voucher for the products or services.
- 2.5 percent of the price will be a transaction fee, while 97.5 percent is sent to the organization selected by the user.

A Social Giver operates under a cross-subsidy model by selling products or services in the normal market, in order to use its profits to support products or services for social purposes. A Social Giver either reinvests or donates all of its profits. Since beginning its operations, 16 organizations have joined the Social Giver platform.

#### **k. Resources**

- [www.boi.go.th/index.php?page=setting\\_up\\_a\\_business](http://www.boi.go.th/index.php?page=setting_up_a_business)
  - [www.dbd.go.th/dbdweb\\_en/ewt\\_news.php?nid=3966&filename=index](http://www.dbd.go.th/dbdweb_en/ewt_news.php?nid=3966&filename=index)
-

## LEGAL STRUCTURE 3 – PUBLIC LIMITED COMPANY

### a. Overview

A public limited company is a legal entity which is established to offer shares for sale to the public, with a profit-seeking aim. The liability of shareholders in a public limited company is limited to the amount payable on their shares. A public limited company is very similar to a private limited company, with the exception that it is governed by the Public Limited Company Act B.E. 2535 (1992) (PLCA) and it is established for the purpose of offering shares for sale to public, rather than private, shareholders.

A public limited company is required by the PLCA to specify its objectives in its MOA, which should set out its social purposes, as well as resolve the conflicts between its profit-seeking aims and social purposes. Corporate documents in a company may be amended according to the PLCA and other related commercial laws. However, there is the risk that the documents may be amended to specify objectives that do not cover social purposes as public shareholders are able to influence company objectives.

### b. Advantages & disadvantages

#### Advantages

- ✓ Liability of shareholders is limited to the amount unpaid on the shares held by them.
- ✓ Less regulation means more flexibility in raising capital, such as through selling shares.
- ✓ Ability to distribute dividends or other benefits to shareholders and employees.
- ✓ Flexibility in respect to social activities and purposes.
- ✓ Social purposes can be incorporated in shareholder agreements and the memorandum of association.
- ✓ Ability to raise capital by selling shares to the public (unlike private limited companies).
- ✓ May qualify for social enterprise promotion tax exemptions under the Royal Decree on Tax Exemption (No. 621) B.E. 2559, if requirements are met.

#### Disadvantages

- ✗ Laws covering public limited companies are designed to maximize profits, not social purposes.
- ✗ Difficulty in permanently fixing social objectives, as objectives may be changed later if the company is acquired or dissolved.
- ✗ Difficulty in balancing profits and social benefits.
- ✗ Difficulty in branding due to dual purpose, and possibly unclear aims, of company.
- ✗ Private profit motive may take a higher priority over social aims.
- ✗ Shares available for purchase on the stock exchange open the company to a higher likelihood of being bought by shareholders who are not interested in social purposes.

### c. Establishment process, documentation & costs

Before going through the process of application and registration, a public limited company must register its MOA with the Ministry of Commerce. The promoters must then offer the company's shares to the public for sale.

A minimum of 15 promoters are required for the application and registration process for establishing a public limited company. The procedure for establishing a public limited company is as follows:

- The name of the company is to be searched for on the DBD database and reserved. This can be done either by submitting a signed Name Reservation Form to the DBD, or filling in a form online and submitting it through the DBD website. If the name is approved, the corporate name will be reserved for 30 days.
  - The MOA must be registered with the Ministry of Commerce. The MOA must contain at least: (1) the company name; (2) the purpose for offering shares for sale to the public; (3) the company objectives, clearly listing its categories of business; (4) its registered capital; (5) the province in which the company will be located; and (6) the names, dates of birth, nationalities, and addresses of the promoters, and the numbers of shares subscribed to them.
  - Registration of the MOA is calculated at THB 1,000 per THB 1 million of registered capital. There is no minimum capital requirement, and the maximum fee is THB 25,000.
  - The company's promoters must offer shares for sale to the public. Each promoter and subscriber must pay off the total amount of their subscribed shares upon registration.
  - There must be a statutory meeting within two months of the shares reaching the level set in the MOA, and six months after the MOA registration. The statutory meeting is to cover: (1) adoption of the company regulations; (2) ratification of contracts; (3) methods for reimbursing expenses incurred by the promoters; (4) the ability to fix preferred shares and ordinary shares; and (5) the appointment of the first directors and the auditors. In order to be valid, resolutions in the statutory meeting must be passed by a majority of at least half of the total number of subscribers eligible to vote.
  - After the statutory meeting, the promoters must hand over control to the directors.
  - The directors must apply for registration of the company within three months, or the statutory meeting shall be voided. The company registration fee is THB 1,000 per THB one million of registered capital. The maximum fee is THB 250,000.
  - The company's registration number will be its tax identification number. Companies with revenue exceeding THB 1.8 million must also register for VAT with the Revenue Department within 30 days from when the annual revenue exceeds that threshold.
  - Any company with at least one employee must register the company's Employer Account directly with the Social Security Office within 30 days of starting employment, under the Social Security Act. Registration of an Employer Account can take one day, if all the required documentation is present.
  - Within three months from the conclusion of the statutory meeting, the board of directors will apply to register the company.
  - All documents are to be submitted to the registrar of the DBD at the Central Registration Office in Bangkok.
-

Required documents for registration:

- Specified total amount of paid-up capital
- Total number of shares sold
- Names, dates of birth, nationalities, and addresses of the directors
- Names and number of directors authorized to sign on behalf of the company, and any limitations to directors' powers as set in the AOA
- Location of the head office and branch offices (if any)

#### **d. Liabilities**

A public limited company is a juristic person, which means it is a legal entity with its own separate obligations and separate liabilities from those of shareholders. As such, the company's shareholders have limited liability, and are not personally at risk under the company's obligations. Their liability is limited to the share price which must be paid. Limited liability often encourages investment by shareholders, which allows for the company to raise more capital for social purposes.

#### **e. Tax treatment**

As a corporation, public limited companies are subject to corporate income tax. In Thailand, corporate income tax for public companies is usually imposed at the rate of 20 percent of net profits. Public limited companies are also required to withhold income tax from the salary of all regular employees.

A public limited company that registers as a social enterprise and meets certain qualifications may enjoy additional corporate income tax exemption as discussed the INTRODUCTION of this chapter.

In addition, companies investing in social enterprises can enjoy corporate income tax exemption of 100 percent of the amount invested in the social enterprise, provided that the social enterprise meets a number of conditions.

#### **f. Ongoing governance and regulatory obligations**

The objectives of the company shall be submitted with its MOA, which is a corporate document which provides the company's objectives and other details. The company's objectives must set out its social purposes, and how to resolve conflicts between its profit-making and social aims. The company must act within its stated objectives.

The company's AOA, however, address the company's rules internally. A company's AOA can include the rights and responsibilities of the directors and shareholders, including setting a provision to state that directors must promote social aims. The company AOA can also allocate company assets for social aims.

Under the PLCA, a public limited company must draft the AOA at a statutory meeting stage, while in a private limited company, there is no such requirement. The PLCA explicitly provides that the MOA and AOA must not be conflicting, and therefore the MOA and the AOA are considered together.

The MOA and AOA, among other corporate documents, can be amended over time through a special resolution passed at a shareholder meeting by at least three-fourths of votes of the attending eligible shareholders. This means that social purposes cannot be permanently fixed within the company's objectives, and a limited company may change its objectives to be purely profit seeking.

The Foreign Business Act B.E. 2543 (2000) is applicable to the for-profit structure of a public limited company.

### g. Corporate structure

A public limited company must:

- have at least 15 natural persons as promoters who are 20 years of age or over;
- have not less than half of the promoters domiciled in Thailand;
- have the promoters subscribe for shares to be paid up in money equal to not less than 5 percent of the total registered capital;
- have at least five directors, the majority of whom must be domiciled in Thailand;
- hold a meeting of the board of directors at least once every three months; and
- have greater flexibility in issuing securities of various kinds (e.g., debentures or warrants).

Directors' proxies are not allowed in public limited companies, and the directors must be appointed through aggregated voting. Directors must hold a board meeting every three months.

### h. Governance

A public limited company must have at least five directors, the majority of whom must be domiciled in Thailand. Foreign directors can hold no more than 49 percent of the shares in a public limited company. Shares can be structured to confer foreign directors with preferred shares, which provide more voting rights and voting power over Thai shareholders even though Thai shareholders must still maintain 51 percent of total shares.

### i. Finance & fundraising

A public limited company splits its capital into a number of shares, which are subscribed to by shareholders. Unlike a private limited company, a public limited company is able to advertise the sale of shares to the public. In order to raise more capital, including to finance a social enterprise, a company may split its shares into smaller portions and sell more shares to new subscribers. Shares cannot be withdrawn as they are permanent capital, but shareholders can freely transfer shares without restrictions.

In order to offer shares to the public on the Stock Exchange of Thailand (SET), a public limited company must comply with the Securities and Exchange Act B.E. 2535 (1992), under the Securities and Exchange Commission (SEC). A public limited company must submit disclosure documents and obtain approval from the SEC, as well as obtain approval from the SET to list shares.

Public limited companies may also utilize personal contributions or fundraising to finance a social enterprise. The Fundraising Control Act B.E. 2487 (1944) is the applicable law which governs fundraising, which is a regulated and licensed activity in Thailand. Foreigners are not prohibited from engaging in fundraising so long as they meet all legal requirements. Additional details on fundraising are mentioned in the INTRODUCTION of this chapter.

### j. Case Study 3

#### SE-Education Public Company Limited

"SE-ED" is an abbreviated term for Science, Engineering, and Education. It has been listed on the Stock Exchange of Thailand since 1991, and was established under the social enterprise concept. In 2003, SE-ED was the founder of an alternative school called Plearnpattana, along with 70 other contributors. The school aims to stimulate educational development and inspire kids to learn.

SE-ED and the Smarter Thais Foundation have jointly initiated other projects such as:

- The Children's Library, which provided over 200,000 books to 3,685 schools and at least one million students;
- The Good Friends Project, which is aimed at improving education programs in 200 schools with 36,107 students; and,
- the expansion of the Total Solution in English Proficiency Project in secondary and vocational schools to develop English competency.

SE-ED uses a financing model that does not cost the company, or affect shareholders' investments. This business management method focuses on creating mass volume of learning materials, thereby reducing their costs. SE-ED has the capacity to produce learning materials for distribution at a low cost, which makes them affordable to the public.

#### **k. Resources**

- [www.boi.go.th/index.php?page=setting\\_up\\_a\\_business](http://www.boi.go.th/index.php?page=setting_up_a_business)
  - [www.dbd.go.th/dbdweb\\_en/ewt\\_news.php?nid=3965&filename=index](http://www.dbd.go.th/dbdweb_en/ewt_news.php?nid=3965&filename=index)
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## LEGAL STRUCTURE 4 – ASSOCIATION

### a. Overview

Associations are one of the most commonly used structures in the social enterprise and charitable fields in Thailand. Fundamentally, this legal structure is a gathering of three or more persons (members), who wish to continually and collectively perform any non-profit activity. Such an association must register its AOA in accordance with the Civil and Commercial Code.

Associations must be registered under Thai law. Fines are applicable should the term “association” be used in business documents without the registration of the association.

### b. Advantages and disadvantages

#### Advantages

- ✓ Flexible structure, as the association is governed by its own articles of association.
- ✓ Easy and simple to operate, with minimal administrative requirements.
- ✓ Low set-up costs.
- ✓ More than one member can be involved in the operation.
- ✓ Can be registered as a charity as well.
- ✓ Tax privileges are available.
- ✓ Non-profit nature assures donors that the association will solely use donations and revenue for social benefits.

#### Disadvantages

- ✗ At least three promoters and 10 members are required.
- ✗ An association can gain profits and income, but it is prohibited from distributing these amounts to its members.
- ✗ Only the directors, and not the members, are authorized to carry out the association’s functions.
- ✗ Heavy reliance on government funding and public donations as the main sources of income.
- ✗ Unsuitable for borrowing money or seeking investment due to its legal structure and inability to issue shares, respectively.
- ✗ Unsuitable for profit-seeking organizations.

### c. Establishment process, documentation & costs

An association can be registered at the relevant district office, based on the jurisdiction of the association’s address. The required documents (three copies each) are as follows:

- Sor. Kor. 1 – Application to establish an association form
  - Articles of association
  - Name, address, and occupation of not less than 10 members
-

- Name, address, and occupation of the directors of the association
- Statutory meeting minutes of the association
- Map of the head office and other offices (if any) of the association
- Consent letter to use the address of the head office, along with the title of ownership or possessory right (e.g., a land deed, or lease agreement – original copies must be reviewed by authorities, and photocopies submitted)
- Identification card(s) of the Thai person(s) or the passport(s) of the foreigner(s)
- Household registry copy (for Thai nationals)

Should the association have a director who is a foreigner, he or she needs to undergo a background check by the Thai National Intelligence Agency and the embassy where he or she holds nationality. Letters from both organizations need to be submitted to the relevant district office where the association will be registered.

The district officer will review all the documents and determine whether any other authorities need to become involved in the association's registration. The applicant will be notified after the association registrar makes a decision on the association's registration. The process takes approximately 60-70 days to complete.

There is a fee of THB 2,005 per association registration application.

#### **d. Liabilities**

An association is a legal entity that is separate from its members. It can therefore hold assets in its own name, and its members will not be personally liable for the debts and other obligations of the association as long as they comply with the laws and the articles of association. If an association intends to hire workers, enter into agreements, or purchase or rent property, the association may use its own funds.

#### **e. Tax treatment**

Associations registered under Thai law are subject to pay corporate income tax on gross income before deduction of any expenses. The tax rates are:

- 2 percent on gross income under section 40 (8) of the Revenue Code (i.e., income from business, commerce, agriculture, industry, transport, etc.).
- 10 percent on any gross income other than income under section 40 (8) of the Revenue Code (i.e., interest, dividend, capital gain, rental, commission, professional fee, etc.).

Associations are exempt from corporate income tax on registration and subscription fees received from members, and on money or properties received as donations or gifts.

Associations prescribed as public charity organizations or institutions under a notification of the Ministry of Finance are exempt from corporate income tax on all kinds of income. Donations to qualifying associations below a specified amount can be deducted from the donor's personal income tax or corporate income tax.

#### **f. Ongoing governance and regulatory obligations**

Every fiscal year, the association is required report its operational performance to the Association Registrar, and provide the following documents:

- Operational report for the past fiscal year
- Audited account and balance sheet for the past fiscal year
- Copies of all minutes of meetings of the board of directors for the past fiscal year

An association is a legal identity that is distinct from its members. It can enter into agreements in its own name, as referred to in its articles of association, and the association's members do not have to individually and personally enter into such agreements.

Associations can gain profit and income, but they are prohibited from distributing such amounts to their members. As it is a non-profit entity, an association can only use its profits and income for continuing its social objectives and the public good.

#### **g. Corporate structure**

To be established, an association requires at least three promoters, whose backgrounds are endorsed by a Level 6 civil servant or higher. The association must also have at least 10 members, who may be divided into ordinary members and honorary members, with the latter possessing most of the rights of ordinary members except the right to vote.

Any change in the board composition (e.g., retirement, removal, or replacement of directors) must be registered with the Association Registrar within 30 days from the date of the meeting which resulted in the changes.

#### **h. Governance**

There is no prohibition against foreigners sitting on the board of directors of an association.

#### **i. Finance & fundraising**

Associations can accept financing and funding from their members. Associations may also utilize fundraising to finance their social enterprise. The Fundraising Control Act B.E. 2487 (1944) is the applicable law which governs fundraising, which is a regulated and licensed activity in Thailand. Foreigners are not prohibited from engaging in fundraising so long as they meet all legal requirements. Additional details on fundraising are mentioned in the INTRODUCTION of this chapter.

#### **j. Case Study 4**

##### **PDA (The Population and Community Development Association Thailand)**

The Population and Community Development Association (PDA) was established by Mr. Mechai Viravaidya in 1974 as a non-governmental and non-profit organization, with the objective to promote family planning and safe sex in Thailand. PDA trained rural residents on sex education, and distributed various types of contraceptives.

The PDA network has reached over one-third of Thailand, and contributed to lowering unplanned pregnancy and sexually transmitted diseases. To date, PDA has operated approximately 300 projects. The PDA also has a business network to support its charitable cause funding, such as Cabbages and Condoms Restaurant in

Bangkok, Birds and Bees Resort in Pattaya, Mountain Resort Saptai C&C in Khao Yai, B.R.E.A.D. (a company which aims to promote education and rural development), and a rice business.

#### k. Resources

- [www.rd.go.th/publish/fileadmin/user\\_upload/roa/aboutus/roa-knowledge.pdf](http://www.rd.go.th/publish/fileadmin/user_upload/roa/aboutus/roa-knowledge.pdf)
  - [www.rd.go.th/publish/44182.0.html](http://www.rd.go.th/publish/44182.0.html)
  - [www.dopa.go.th/public\\_service/service\\_guide30](http://www.dopa.go.th/public_service/service_guide30)
  - [www.dopa.go.th/public\\_service/service\\_guide143/view144](http://www.dopa.go.th/public_service/service_guide143/view144)
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## LEGAL STRUCTURE 5 – FOUNDATION

### a. Overview

A foundation consists of property allocated to public charity, religion, arts, science, education, or other purposes for public benefit and not profit. A foundation must be registered and state the term “foundation” in its name.

### b. Advantages & disadvantages

#### Advantages

- ✓ Flexible structure, as the foundation is governed by its own articles of association
- ✓ Easy and simple to operate, with minimal administrative requirements
- ✓ Low set-up costs
- ✓ Can be registered as a charity as well
- ✓ Tax privileges are available
- ✓ Non-profit nature assures donors that the foundation shall use its donations and revenue entirely for social benefits

#### Disadvantages

- ✗ A foundation can gain profits and income, but it is prohibited from distributing these amounts to its members
- ✗ Difficulties in seeking private investment, as the foundation cannot issue shares
- ✗ Heavy reliance on government funding and public donations as the main sources of income
- ✗ Unsuitable for borrowing money or seeking investment due to its legal structure and inability to issue shares, respectively
- ✗ Unsuitable for profit-seeking organizations

### c. Establishment process, documentation & costs

A foundation can be registered at the relevant district office, based on the jurisdiction of the foundation’s address. Three copies of each of the following documents are required:

- Mor. Nor. 1 – Application to establish a foundation
  - Articles of association
  - Name, address, and occupation of the directors of the foundation (at least three people)
  - Evidence of name change (if applicable)
  - Statutory meeting minutes of the foundation
  - Interview record on the status and good behavior of the directors of the foundation, as well as certification made by the directors of the foundation
  - Approval letter from the founder of the foundation, or the heir, or other relevant government authorities
-

- Identification card(s) of the Thai person(s), or the passport(s) of the foreigner(s) for the property owner and the directors of the foundation (certified true and correct copy)
- Household registry copy for the property owner and the directors of the foundation (certified true and correct copy)
- Bank certificate confirming the deposit of such property at the bank (must be from the bank that holds such property)
- For land property allocated to the foundation, there shall be a title deed and a land valuation report
- A copy of a will, in the case of an estate-granted property to the foundation, and written representation that the property will be granted to the foundation by the property owner, as well as the bank's certification

One original copy and two photocopies of the following documents are required:

- Map of the head office and other offices (if any) of the foundation
- Consent letter to use the address of the foundation with the title of ownership or possessory right
- Management authority over the land (e.g., title deed of the land, land sale and purchase agreement, construction permit, lease agreement, and company affidavit, if any)

Should the foundation have a director who is a foreigner, he or she needs to undergo a background check by the Thai National Intelligence Agency and the embassy of his or her nationality. Letters from both organizations need to be submitted to the relevant district office where the foundation will be registered.

The entire process takes approximately 60 days to complete. First, the district officer will review all the documents and determine whether any other authorities need to become involved in the foundation's establishment. The applicant will be notified after the Foundation Registrar makes a decision on the foundation's registration.

The application fee is THB 210 per application. Other fees may apply if additional filings are required.

#### **d. Liabilities**

A foundation has a legal identity that is separate from that of its members. It can therefore hold assets in its own name, and its members will not be personally liable for the debts and other obligations of the foundation should members comply with the laws and the articles of association. If a foundation intends to hire workers, enter into agreements, or purchase or rent property, the foundation may use its own funds.

#### **e. Tax treatment**

Foundations are subject to corporate income tax and the same conditions for tax exemption as associations.

#### **f. Ongoing governance and regulatory obligations**

In March of every year, foundations are required to report their operational performance to the foundation registrar, and provide the following documents:

- Operational report for the past fiscal year
  - Audited account and balance sheet for the past fiscal year
  - Copies of all minutes of meetings of the board of directors for the past fiscal year
-

A foundation is a legal identity that is distinct from its members. It can enter into agreements in its own name, as referred to in its articles of association, and foundation members do not have to individually and personally enter into such agreements.

Foundations can gain profits and income, but they are prohibited from distributing such amounts to their directors. They are non-profit entities, and thus, they can only use their profits and income for continuing their social objectives and public good.

### **g. Corporate structure**

A foundation requires regulations and a board of directors, consisting of at least three persons, in order to conduct its business. The law requires that any change in the board composition must be registered with the foundation registrar within 30 days from the date of the meeting which resulted in changes to the board composition (e.g., retirement, removal, or replacement of directors).

### **h. Governance**

There is no prohibition against foreigners sitting on the board of directors of a foundation.

### **i. Finance & fundraising**

A foundation must have funds of not less than THB 500,000 in cash, or THB 250,000 in cash and other properties that have a combined value of not less than THB 500,000. Foundations for social welfare, education promotion, sports, religion, public hazard mitigation, health treatment, AIDS prevention, drug rehabilitation, or which are government-funded foundations, must have funds of not less than THB 200,000.

Representatives or managers of a foundation will allocate or manage the foundation's property, the profits from which must be solely used for the foundation's social causes and charitable purposes. That is to say, representatives or managers of foundations are not authorized to appropriate the profits for their personal gain. For example, they cannot appoint a relative to be a director of a foundation, and then grant them an unreasonably high remuneration, because this will indirectly lead to the sharing of profits to the representative or manager, and this would be considered tax evasion on their personal incomes.

Foundations may use fundraising to finance their social enterprise. The Fundraising Control Act B.E. 2487 (1944) governs fundraising, which is a regulated and licensed activity in Thailand. Foreigners can engage in fundraising so long as they meet all legal requirements. Additional details on fundraising are mentioned in the INTRODUCTION of this chapter.

### **j. Case Study 5**

#### **Chao Phya Abhaibhubejhr Hospital Foundation**

The Hospital Foundation was established in 2002 to preserve knowledge about traditional medical and Thai herbs. It uses revenue from manufacturing and selling Thai herbs to support its hospital expenses and educate the Thai public on herbs and their health benefits. The Hospital Foundation encourages farmers to conduct organic farming by using a forward purchase contract, with produce processed and distributed through various channels in urban areas.

At present, there are nine organic farming zones, which help deter urbanization, and promote local employment in rural areas. Farmers can earn revenue to pay off debts using the communal fund available. There is also a self-funded center, which promotes organic farming in rural communities.

The Hospital Foundation generates annual sales revenue of over THB 400 million (about USD 11.4 million). About 70 percent of the foundation's revenue is distributed to the hospital for medical expenses, while 30 percent of the revenue is used to develop herbal products and support other social causes.

**k. Resources**

- [www.dopa.go.th/public\\_service/service\\_guide30](http://www.dopa.go.th/public_service/service_guide30)
  - [www.rd.go.th/publish/44182.0.html](http://www.rd.go.th/publish/44182.0.html)
-



## LEGAL STRUCTURE 6 – COOPERATIVE

### a. Overview

A cooperative, under the Cooperative Act B.E. 2542 (1999), is a registered group of persons who conduct affairs for collective socioeconomic interests on the basis of self-sufficiency. In Thailand, there are seven types of cooperatives available:

- agricultural cooperatives;
- fisheries cooperatives;
- land settlement cooperatives;
- consumer cooperatives;
- thrift and credit cooperatives;
- service cooperatives; and
- credit unions.

After registration, the cooperative must include the words “cooperative limited” in its name.

### b. Advantages & disadvantages

#### Advantages

- ✓ Separate legal entity, with liability of members limited to their share capital.
- ✓ Flexible governance arrangements.
- ✓ Exemption from certain government fees for immovable property transactions.
- ✓ Exemption from corporate income tax and certain stamp duties.
- ✓ Access to various funding such as the Cooperative Development Fund.

#### Disadvantages

- ✗ Restrictions on distribution of profits.
- ✗ Requirement to comply with ongoing reporting requirements.

### c. Establishment process, documentation & costs

A cooperative must be established by registration under the law, and must have as its objectives the promotion of the socioeconomic interests of its members by means of self-help and mutual assistance, in accordance with the cooperative principles. It must also satisfy the following criteria:

- have common business affairs according to the type of cooperatives which are proposed for registration;
  - have natural persons who are of legal age as members;
  - have capital which is divided into shares of equal value, with each member holding at least one share, but not more than one-fifth of the total paid-up shares; and,
  - have qualified members.
-

The procedure for forming and registering cooperatives is as follows:

- Natural persons who are of legal age and have common needs or interests form a group.
- A statutory meeting is held to appoint at least 10 persons to a board of cooperatives.
- The board of cooperatives selects the type of cooperative and its objectives, makes a business plan, and creates a list of prospective members' names and allocated shares.
- Articles of association are drafted and adopted.
- The board of cooperatives files an application to register the cooperative at the provincial or district cooperative office, including;
  - » the application form to registration of the cooperative;
  - » two copies each of the minutes of the meeting to select the board of cooperatives and the minutes of the meeting to adopt the articles of association;
  - » two copies of the business plan relating to the business or activities of the cooperative;
  - » two copies of the lists of the members' names, together with their signatures and the number of shares each person will hold; and
  - » four copies of the articles of association.

The provincial or district office will forward the application to the cooperatives registrar, which will take approximately 15 days to consider it, and will register successful cooperatives within 30 days of receiving the application, with no fee.

#### **d. Liabilities**

A cooperative has a separate legal identity from its members. It can therefore hold assets in its own name, and its members will not be personally liable for the debts and other obligations of the association should members comply with the laws and the articles of the cooperative. The may use its own funds to hire workers, enter into agreements, or purchase or rent property.

#### **e. Tax treatment**

Registered cooperatives are exempt from corporate income tax.

#### **f. Ongoing governance and regulatory obligations**

At least 10 percent of the annual net profit of the cooperative must be contributed to the reserve fund, and not more than 5 percent of its annual net profit must be contributed to the Cooperative League of Thailand. The remaining annual profit, subject to cooperative's articles of association of the cooperative, may be appropriated by the general meeting as:

- dividends on paid-up shares, not exceeding the rate prescribed for each type of cooperative in ministerial regulations;
- a patronage refund to the members, in proportion to the volume of business which they conducted with the cooperative during the year;

- bonuses to the members of the board of directors and other cooperative personnel, not exceeding 10 percent of the net profit; and,
- contributions to accumulated funds for carrying out any activity of the cooperative, as prescribed in the articles of association.

A cooperative is required to maintain and retain all its accounts at its office. Any cash transactions must be recorded and accompanied by relevant evidence on the date when the transactions occurred. Transactions not involving cash must be recorded in the accounts within three days.

A cooperative needs to make a balance sheet for every accounting year. The balance sheet must declare the cooperative's assets, liabilities and capital, and profits and losses. It must be audited and then submitted, for approval, to a general meeting of the cooperative within 150 days from the last date of the accounting year.

A cooperative must produce an annual report showing the results of its operations and submit it, with its balance sheet, to the cooperatives registrar within 30 days of the meeting.

A cooperative is required to keep the annual reports of its operations, the balance sheets, and the articles of association at its office, for inspection by the members.

### **g. Corporate structure**

All cooperative members are owners of the cooperative, but not all owners can administer it. They must therefore elect a board of directors to act on their behalf.

In order for a cooperative to carry on its affairs and serve all (or most) of its members, the board of directors employs a manager to carry out the business of the cooperative. The manager, in turn, employs and supervises employees in performing the cooperative's day-to-day operations.

A cooperative's board of directors consists of a chairperson and up to 14 board members who have been elected by a general meeting of the cooperative. The directors are elected for two years each. Anyone with the following attributes is prohibited from being a director:

- Previously served a final judgment of imprisonment, except for punishment for recklessness or misdemeanor offences.
- Was expelled or dismissed from government service, government, or private organizations due to dishonesty in the conduct of his or her duties.
- Was dismissed, or is to be dismissed, from the board of directors of a cooperative by a final ruling of the cooperative registrar with regard to any involvement in any defects relating to finance, accounting, performance, or financial conditions according to the audit report or the inspection report.
- Was dismissed from the board of directors by a general meeting of a cooperative due to dishonesty in the conduct of his or her duties.

### **h. Governance**

Cooperatives are covered by a special business law, with various taxation benefits and waivers of government fees. The law's objectives are to support Thai citizens who have hardships, in order to help them support each other and collectively work together. Therefore, cooperative members and directors must be Thai nationals, and foreigners are prohibited.

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### i. Finance & fundraising

A cooperative can accept financing and funding from its members, subject to compliance with the Cooperatives Act's regulations and requirements.

Cooperatives may fundraise to finance their social enterprise, provided they meet the requirements discussed in the INTRODUCTION of this chapter.

### j. Case Study 6

#### **Border Patrol Police Sub-division 24 Savings and Credit Cooperative Limited (BPC24 Cooperative)**

The BPC24 Cooperative was established in 1971 with the objective to promote financial and social benefits for its members, in order to achieve sustainability and self-sufficiency. It accepts savings deposits and provides loans to its members, and also provides inter-cooperative lending. In 2015, it had over 1,700 members, over THB 100 million (about USD 2.87 million) in members' savings deposits, and THB 678 million (about USD 19.3 million) in capital. It has entered into over 2,000 loan agreements with its members and achieved net profits of THB 59 million (about USD 1.68 million) in 2015.

### k. Resources

- [www.coop-thailand.com/en/cooperatives-in-thailand](http://www.coop-thailand.com/en/cooperatives-in-thailand)
  - <http://www.cpd.go.th/>
-

## LEGAL STRUCTURE 7 – REGISTERED COMMUNITY ENTERPRISE / NETWORK

### a. Overview

The Thai government promotes community enterprises by providing funding options and benefits under the Community Enterprise Promotion Act B.E. 2548 (2005). This law originated from the “One Tambon One Product” policy, which promotes development of various community products.

To qualify, a business must be related to producing goods, providing services, or other matters that lead to community development and problem solving. Community enterprises are formed from existing unregistered ordinary partnerships or non-juristic bodies of persons, for the benefit of a community. Upon registration, the legal structure’s name must include the term “community enterprise.”

### b. Advantages & disadvantages

#### Advantages

- ✓ Flexible governance arrangements
- ✓ Can request extension services or support from the government
- ✓ Tax benefits

#### Disadvantages

- ✗ Restrictions on the distribution of profits
- ✗ Mandatory compliance with ongoing reporting requirements

### c. Establishment process, documentation & costs

To qualify, the business must be related to producing goods, providing services, or other matters that lead to community development and problem solving. The business needs to be collectively operated in the community by a group of persons (either natural persons or juristic persons). The group must include at least seven people from different families who live in the community. The business must be for profit, self-sufficiency, and the benefit of the community. The business cannot be unlawful or against public morals or public order.

It takes approximately 15 days to register a community enterprise at a Subdistrict Agricultural Technology Transfer and Service Center, Office of Agriculture, which are located in various provinces. The following documents are required:

- Sor. Wor. Cho. 1 – Application to register the community enterprise
  - Consent from the members (at least half of the total number of members) or a copy of the minutes of the meeting resolution which assigns such person to register the community enterprise (for a non-juristic person)
  - Identification card of the applicant
  - List of names and addresses of the members
  - Documents showing the objectives, regulations, or articles of association of the juristic person
  - List of the board of directors names (for a juristic person)
-

- Minutes of the board of directors meeting or general meeting of shareholders (for a juristic person which wishes to register as a community enterprise)

There is no applicable fee for such registration.

#### **d. Liabilities**

Registration as a community enterprise does not create a separate legal entity, and the extent of liability depends on the previous form of entity of the applicant. Registration will not affect the current corporate structure of the applicant (e.g., if the applicant is a private limited company, its liability will be as a private limited company only).

#### **e. Tax treatment**

Subject to conditions, personal income tax exemption was previously available for natural persons who operate a community enterprise registered under the Community Enterprise Act. To be eligible, the registered community enterprise must operate in the form of a non-registered ordinary partnership or a non-juristic body of persons, with income under THB 1.8 million per tax year.

The tax exemption was applicable for the 2009-2016 tax years, and would require reauthorization from relevant authorities to continue.

#### **f. Ongoing governance and regulatory obligations**

A community enterprise must maintain all of its accounting and tax filings for at least five years from the filing date. Other governance and regulatory obligations will depend on the original entity form prior to registration as a community enterprise.

#### **g. Corporate structure**

A community enterprise must be operated in a community by a group of at least seven persons (natural or juristic), who live in the community, and do not come from the same family. Two or more community enterprises may register to form a network.

#### **h. Governance**

Foreigners are prohibited from becoming members of a community enterprise.

#### **i. Finance & fundraising**

Charitable public fundraising activities are regulated under the Fundraising Control Act B.E. 2487 (1944), as mentioned in the INTRODUCTION of this chapter.

#### **j. Case Study 7**

##### **Kanchanaburi Dry Flowers Crafts**

This community enterprise was established in 2005, with 15 starting members. By 2015, there were over 40 members. Kanchanaburi Dry Flowers Crafts aims to address the pervasive drought situation in the Nong Song area of Kanchanaburi province by developing alternative means of livelihood besides agriculture. Tree bark, leaves, grass, flowers, and woodchips in the community were used as raw material for creating crafts. Various plants and flowers were dyed, decorated, and sold as crafts. These products created much value, and have thus far been sustainable and helped to support the community. This community enterprise is registered and supported by the Kanchanaburi Agricultural Office.

To date, each member can earn over THB 4,800-9,000 per month from the enterprise's earnings. The community enterprise also provides knowledge transfer and training to students, housewives, and other interested persons. Kanchanaburi Dry Flowers Crafts also holds an annual food festival for children from Nong Song Ton School on National Children's Day, and holds fundraising activities for Nern Pra Ngam Temple each year.

#### k. Resources

- [www.dopa.go.th/public\\_service/service\\_guide30](http://www.dopa.go.th/public_service/service_guide30)
- <http://smce.doae.go.th/>

As a summary, the available legal structures for social enterprises which have been included in this report are as follows:

1. Partnership
  2. Private Company Limited
  3. Public Company Limited
  4. Association
  5. Foundation
  6. Cooperative
-

We have also provided a table, which compares these existing legal structures, together with the proposed social enterprise model under the Social Enterprise Promotion Bill.

*\*Please note that the **community enterprise** structure is not included in the table, because it is not a legal structure per se; it is merely a registration to obtain certain benefits from the government. The community enterprise's features will depend on the existing structure it has prior to registration as a community enterprise e.g. whether it is a private limited company or a registered partnership etc.*

|                                           | Social Enterprise Bill's structure (not legally effective yet)                                             | 1. Partnership                                                                                          | 2. Private Company Limited                                         | 3. Public Company Limited                                                                                                                    | 4. Foundation                                                                                                                                            | 5. Association                                                         | 6. Cooperative                                                                                                 |
|-------------------------------------------|------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|
| <b>Overview</b>                           | Dual purpose of profit-seeking and social causes                                                           | Traditionally aimed at maximizing profit for its partners                                               | Traditionally aimed at maximizing profits for its shareholders     | Traditionally aimed at maximizing profit for its shareholders                                                                                | Non-profit and acts for public charities, religion, arts, science, education, or other public benefits                                                   | Non-profit                                                             | Act for the members' best interest                                                                             |
| <b>Ongoing Governance</b>                 | Directors to manage business on behalf of the shareholders, and simultaneously contribute to social causes | Managing partner to manage the business on behalf of the partners                                       | Directors to manage the business on behalf of the shareholders     | Directors to manage the business on behalf of the shareholders. Stringent governance regulations, especially if listed on the stock exchange | Directors of the foundation oversee the activities of the foundation                                                                                     | Directors of the association oversee the activities of the association | Directors of the cooperative oversee the activities of the cooperative                                         |
| <b>Dividends distribution</b>             | Yes, but with restricted dividend distributions to investors                                               | Yes                                                                                                     | Yes                                                                | Yes                                                                                                                                          | No                                                                                                                                                       | No                                                                     | Yes                                                                                                            |
| <b>Income Tax Rates Applicable (2016)</b> | Tax-exempted (subject to conditions)                                                                       | 20 percent of net profits                                                                               | 20 percent of net profits                                          | 20 percent of net profits                                                                                                                    | Some categories of income exempt; 2 percent or 10 percent on gross income of other categories, unless Ministry of Finance grants exemption of all income | Same as a foundation                                                   | Tax-exempted                                                                                                   |
| <b>Liability</b>                          | Limited                                                                                                    | Unlimited for a non-registered ordinary partnership<br><br>Limited for a registered limited partnership | Limited                                                            | Limited                                                                                                                                      | Limited                                                                                                                                                  | Limited                                                                | Limited                                                                                                        |
| <b>Share issuance</b>                     | Yes                                                                                                        | Yes – but only privately                                                                                | Yes – but only privately, and it cannot issue shares to the public | Yes – it can issue shares to the public                                                                                                      | No                                                                                                                                                       | No                                                                     | Yes – can seek certain qualified members from the public (e.g. those suffering from poverty and hardship etc.) |
| <b>Acceptance of charitable donations</b> | Yes                                                                                                        | Generally prohibited                                                                                    | Generally prohibited                                               | Generally prohibited                                                                                                                         | Yes                                                                                                                                                      | Yes                                                                    | Generally prohibited                                                                                           |



**Other general questions:****Q1: Is it advisable to have more than one legal form?**

**A1:** This depends on the forms of income. For example, should the principal income of the social enterprise be derived from charity, a foundation would be a more suitable legal structure for the social enterprise. Currently, there is no hybrid legal structure available under Thai law (awaiting the enactment of the Social Enterprise Bill). Therefore, it is advisable to have more than one legal form, depending on the nature of the financing of the social enterprise.

**Q2: Can a charity/NGO transition into a social enterprise model?**

**A2:** Again, there is yet to be any complete social enterprise model under the specific law (awaiting the enactment of the Social Enterprise Bill), and hence, there is no transition procedure available as of now. However, a charity and NGO can register itself as a 'social enterprise' under the company registration database, but this is only in form and not in substance, as a complete social enterprise unit is yet to be supported under the law.

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# VIETNAM





# VIETNAM

## INTRODUCTION

In Vietnam, organizations that perform charitable and non-profit functions can be found under both formal (e.g., social relief organizations, social funds and international non-governmental organizations) and informal (e.g., voluntary clubs and religious organizations) structures. However, with conventional charitable activities and donations seemingly becoming unsustainable, there has been recent increased demand for a legal framework to enable social enterprises to simultaneously generate business profits while pursuing a social mission in the community.

To meet society's needs, Vietnamese lawmakers recognized the legal concept of "social enterprises" for the first time under the new Law on Enterprises of Vietnam (LOE), effective since July 1, 2015. A dedicated legal framework for the establishment and operation of social enterprises is further detailed under the LOE's detailed legal guidance documents—Decree No. 96/2015 and Circular No. 04/2016.

With the LOE assigning a clear responsibility to the government to issue policies to "encourage, support and promote the development of social enterprises," the social enterprise trend is developing swiftly and strongly in Vietnam.

Like a non-social enterprise, a social enterprise is established under the provisions of the LOE. Under Article 10 of the LOE, the two typical characteristics distinguishing a social enterprise from a non-social enterprise are: (1) having the objective to resolve social or environmental issues in the interest of the community; and (2) having at least 51 percent of its profits reinvested to accomplish its registered social or environmental objective.

Upon establishment, similar to a non-social enterprise, a social enterprise may take any of the following business forms: a private enterprise, a single-member limited liability company (1LLC), a multiple-member limited liability company (MLLC), a shareholding company (SC), or a partnership. Social enterprises have all corresponding rights and obligations of their business forms, as well as other rights and obligations dedicated to social enterprises.

Since the LOE took effect, more than 20 social enterprises have been established, including new social enterprises and those converted from non-social enterprise structures. Most of these organizations have registered offices in Ho Chi Minh City or Hanoi.

Within the scope of this chapter, we will discuss the three most common social enterprise forms: 1LLC, MLLC and SC.

## Overview

Similar to a non-social enterprise,  
a social enterprise is established under the Law on  
Enterprises with all the same liabilities as an enterprise

**1LLC social enterprise**

- Owned by one organization or individual.
- May not issue shares.
- The owner is liable for all of the enterprise's debts and other property obligations within the amount of its charter capital.
- The owner will have total control.

**1LLC social enterprise**

- Owned by multiple organizations or individuals called members, but may not have more than 50 members.
- May not issue shares.
- A member is liable for the debts and other property obligations of the enterprise within the amount of capital that the member has undertaken to contribute to it.
- Shared responsibilities and cost of investment among members.

**SC social enterprise**

- Owned by multiple organizations or individuals called shareholders, with a minimum of three shareholders and no restriction on the maximum number of shareholders.
- May issue shares and bonds.
- A shareholder is liable for the debts and other property obligations of the enterprise only within the amount of capital it has contributed to it.
- Founding shareholders shall hold at least 20 percent of the ordinary shares at the registration date.

Social enterprises under all forms of business establishment have two typical characteristics: (1) having the objective to resolve social or environmental issues in the interest of the community and (2) having at least 51 percent of profits reinvested to accomplish social and environmental objectives as registered.

## CHART

## LEGAL STRUCTURE 1 – SOCIAL ENTERPRISE UNDER THE FORM OF A SINGLE-MEMBER LIMITED LIABILITY COMPANY (1LLC)

### a. Overview

Similar to a conventional 1LLC, a social enterprise in the form of a 1LLC (1LLC SE) is an enterprise owned by one organization or individual having the rights and obligations of a 1LLC. The owner of the 1LLC SE is liable for all of its debts and other property obligations within the amount of its charter capital.

A 1LLC SE can only reduce its charter capital in the following cases:

- It returns part of the owner's capital contribution in its charter capital, provided that the 1LLC SE has carried out business activities continuously for more than two years from the date of enterprise registration, and ensures payment of all of its debts and other property obligations after the capital is returned to the owner; or
- The charter capital is not paid in full and on time by the owner as required.

### b. Advantages & disadvantages

#### Advantages

- ✓ The owner will have total control over the operation of a 1LLC SE.

#### Disadvantages

- ✗ A 1LLC SE has limited access to finance as it may not issue shares.

### c. Establishment process, documentation & costs

The 1LLC SE must register its establishment with the licensing authority (e.g., Department of Planning and Investment ("DPI")) of the city or province where its head office is located, in accordance with the applicable processes, procedures, and application file prescribed in the LOE.

The application file shall include (1) the registration application for establishment, similar to a non-social enterprise 1LLC (e.g., application in prescribed form, decision on establishment of 1LLC SE of the owner, and draft company charter), and (2) the commitment to implement the social and environmental objectives (Commitment), which clearly specifies:

- The social or environmental issues intended to be solved by the social enterprise;
- The methodology for solving the social or environmental issues;
- The duration of operation to solve the social or environmental issues;
- The annually retained profit reinvested for solving the social or environmental issues; and
- The principles and use of donations, and settlement of outstanding donations in case of dissolution or restructuring of the social enterprise (if any).

The Commitment is only required to be submitted for the establishment of a SE, and will be made in prescribed form.

At the end of this process, the licensing authority will grant the 1LLC SE an Enterprise Registration Certificate (ERC). The time limit by law to issue the ERC is within three working days from the date of receipt of a complete and valid dossier. This process may take longer in practice, depending on the nature and complexity of the application.

If the 1LLC SE has a foreign investor(s), the procedure for investment registration under the Law on Investment (LOI) needs to be completed prior to the registration of the social enterprise (prior to obtaining the ERC). The completion of this process will grant the investor(s) an Investment Registration Certificate (IRC).

An existing 1LLC can convert to a 1LLC SE by sending a written notification of its commitment to implement its social and environmental objectives (i.e., the Commitment) to the licensing authority of the city or province where the head office is located. The licensing authority will update its conversion of the social enterprise on the National Business Registration Portal.

The government fee for the ERC is VND 200,000 (approx. USD 8.70) and for declaration of contents of enterprise is VND 300,000 VND (approx. USD 13.05). The IRC is granted free of charge by the licensing authority.

There is no fee for the conversion of an existing 1LLC to a 1LLC SE.

#### **d. Liabilities**

These regulations apply to social enterprises under all forms of business establishment.

##### **Liabilities as a normal enterprise**

The social enterprise will have all liabilities as an enterprise under Vietnamese law. In particular:

- To satisfy all business conditions when conducting business in the lines of business investment which are subject to conditions in accordance with the LOI and to ensure maintenance of all such business investment conditions during the process of business operation;
  - To organize accounting work and to prepare and submit truthful and accurate financial statements on time in accordance with the law on accounting and statistics;
  - To declare and pay taxes and to perform other financial obligations as stipulated by law;
  - To ensure the lawful and legitimate rights and interests of employees in accordance with the labor law; not to discriminate between or offend the honor and dignity of employees in the enterprise; not to use forced labor and child labor; to support and facilitate its employees to participate in training to improve their qualifications and technical skill; to implement the regimes of social insurance, job loss insurance, health insurance, and other insurance for employees in accordance with law;
  - To ensure and be responsible for the quality of goods and services in accordance with standards stipulated by law or registered or declared standards;
  - To fully and promptly perform the obligations regarding enterprise registration, registration of change to contents of enterprise registration, public disclosure of information about establishment and operation, reporting and other obligations in accordance with the LOE, and other provisions of relevant law;
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- To be responsible for the honesty and accuracy of information declared in the application file for enterprise registration and in reports; and to promptly make amendments of and additions to such information on discovery of any information which was declared or reported inaccurately or incompletely;
- To comply with the law on national defense, security, social order and safety, gender equality, protection of natural resources and environment, and protection of historical and cultural sites and places of scenic beauty; and
- To perform obligations in respect of business ethics in order to ensure lawful rights and interests of customers and consumers.

### Liabilities as a normal enterprise

- To maintain the registered Commitment and register any change to the registered Commitment; and
- To return any incentive or donation enjoyed by the social enterprise in case of a failure to implement, or an improper implementation of, the registered Commitment.

### e. Tax Treatment

These regulations apply to social enterprises under all forms of business establishment. There are no separate provisions on tax incentives for a social enterprise under the current Law on Corporate Income Tax of Vietnam. However, there is an implication that if an enterprise's operations/business are for the benefit of social communities, such enterprise may be given tax incentives in one of the following forms:

- Tax exemption
- Preferential tax rate
- Tax reduction

Subject to the registered business of the social enterprise, the following income may be tax-exempt:

- Income earned from production activities and business in goods and services by enterprises employing an average of 20 or more employees in a year, with 30 percent or more of those employees being disabled people, reformed addicts, or people infected with HIV/AIDS;
- Income earned from occupational training activities specially reserved for ethnic minorities, people with disabilities, children living in particularly difficult conditions, and reformed offenders;
- Aid funds receivable for use in educational, scientific research, cultural, artistic, charitable, humanitarian, or other social activities in Vietnam; and

### Preferential tax rate

A preferential tax rate of 10 percent (with no limit on the duration) will apply to enterprise income earned from conducting socialization activities in the sectors of education and training, vocational training, medical health, culture, sports, and the environment.

The duration of the preferential tax rates will be calculated from the first year the enterprise has turnover.

## f. Ongoing Governance and Regulatory Obligations

### Requirements on receipt of donations

The regulations below apply to social enterprises under all forms of business establishment.

Receipt of aid must be made in writing to clearly record the information of the aid provider, the type of asset and its value or the value of monetary aid, the duration of providing aid, requirements applicable to the recipient enterprise, and the full names and signatures of authorized representatives of the parties.

Any receipt of foreign non-governmental aid or donation must be in accordance with Vietnamese regulations on foreign non-governmental aid.

### Corporate governance

A decision on termination of the social or environmental objectives of the social enterprise or revision of the Commitment must be passed by members representing at least 75 percent of the contributed capital of attending members at a members' council meeting or by the chairman of the 1LLC SE, as the case may be.

### Notification/reporting obligations

The regulations below apply to social enterprises under all forms of business establishment.

Upon the occurrence of any of the following events, the social enterprise must notify the licensing authority or the agency managing aid under the provincial people's committee in the locality where the social enterprise has its headquarters:

- Any receipt of aid, within five business days after the date of signing the aid agreement. A copy of the agreement must be enclosed;
- Any change to the aid agreement (the aid provider, the type of asset and its value or the value of monetary aid, the duration of providing aid, requirements applicable to the recipient enterprise);
- Any change to the Commitment, within five business days after the date of the decision on the change;
- The termination of the Commitment, within five business days after the date of the decision on such termination

In case the social enterprise receives aids, sponsorship, the social enterprise must submit an annual report on the social impact of the activities it has undertaken to the licensing authority or to the agency managing aid under the provincial people's committee in the locality where the enterprise has its headquarters.

The report needs to include:

- Name of the enterprise and its code number;
- Items that are incentives, aid, and assistance received;
- Activities undertaken by the enterprise during the year, and the social or environmental issues which it resolved; and
- Social benefits and achievements of the enterprise, and the group of entities [or subjects] who enjoyed such achievements, including supporting evidence.

The social enterprise must also submit ad hoc reporting as requested by the licensing authority.



### Requirements on termination/dissolution/restructuring

The regulations below apply to social enterprises under all forms of business establishment.

**Termination of Commitment:** All residual assets or finance received in the form of aid or assistance must be returned to the aid provider, or transferred to another social enterprise or organization with similar social objectives. A social enterprise is only permitted to terminate its Commitment if it is deemed as able to fully pay debts and other asset obligations after the return of residual aid or assistance has been factored in.

**Dissolution:** The residual assets or finance received by the social enterprise must be returned to the aid provider, or transferred to another social enterprise or organization with similar social objectives.

### Restructuring:

- *Division or demerger:* A social enterprise can be divided or demerged into a number of smaller enterprise(s) and those enterprises established after the division or demerger shall be the social enterprises.
- *Consolidation:* The consolidating enterprise(s) can be either ordinary enterprise(s) or social enterprise(s), but the consolidated enterprise (after consolidation) must be a social enterprise.
- *Merger:* Either ordinary enterprise(s) or social enterprise(s) can merge into a social enterprise.

### Member obligation/restriction on transfer of shares

- A member of the 1LLC SE (i.e., the owner) is only permitted to assign his/her capital contribution portions in the social enterprise to other organizations or individuals who undertake to continue to conduct the activities of the 1LLC SE for social or environmental objectives.
- A member of the 1LLC SE (i.e., the owner) will be liable for the refund of the incentives, aid, and assistance received, and to pay compensation for loss arising from breach of Commitment by the social enterprise.

### g. Corporate structure

One or more persons are appointed as authorized representatives of the 1LLC SE.

If one person is appointed, he/she will be the chairperson and the 1LLC SE will be managed by the chairperson, a general director, and an inspector(s).

If two or more persons are appointed, the 1LLC SE will be managed by a members' council, the general director, and an inspector or inspection committee. The general director manages the day-to-day business operations of the 1LLC SE. The office terms of the general director, members' council, and inspector(s) are up to five years while there is no limitation on the maximum office term of the chairperson.

### h. Governance

There are regulations governing the board composition of the 1LLC SE.

As discussed in item 1.1(g), if two or more persons are appointed to be the authorized representatives of the owner, the 1LLC SE will be managed by a members' council, the general director, and an inspector or inspection committee.

There are no restrictions on a foreign citizen sitting on the board.

**i. Finance & fundraising**

A social enterprise is permitted to raise and receive funding [aid] in various forms from individuals, enterprises, non-governmental organizations, and other Vietnamese or foreign organizations in order to cover managerial and operational expenses of the enterprise. Specifically, it is permitted to receive sponsorship in the form of property, money, or technical assistance from domestic or foreign entities that have registered to operate in Vietnam to resolve social and environmental issues.

There is a restriction that a social enterprise cannot use funding raised for purposes other than the purpose of covering managerial and operational expenses in order to resolve social or environmental issues registered by the enterprise.

For the tax implications for different finance/funding options, please see section 1.1(e) tax treatment.

## LEGAL STRUCTURE 2 – SOCIAL ENTERPRISE UNDER THE FORM OF A MULTIPLE-MEMBER LIMITED LIABILITY COMPANY (MLLC)

### a. Overview

Similar to a conventional MLLC, a social enterprise in the form of an MLLC (MLLC SE) is an enterprise owned by multiple organizations or individuals called members.

An MLLC SE may not have more than 50 members, and each member is liable for the debts and other property obligations of the MLLC SE within the amount of capital that the member has undertaken to contribute to the MLLC SE.

An MLLC SE can reduce its charter capital in the following cases:

- It returns part of a member's capital contribution in its charter capital, provided that the MLLC SE has carried out business activities continuously for more than two years from the date of enterprise registration, and ensures payment of all of its debts and other property obligations after the capital is returned to the member;
- It buys back a member's capital contribution in certain cases stipulated under the LOE; or

The charter capital is not paid in full and on time by the members as required.

### b. Advantages & disadvantages

#### Advantages

- ✓ The responsibilities and cost of investment of the MLLC SE are shared among members.

#### Disadvantages

- ✗ Similar to a 1LLC SE, an MLLC SE may not issue shares, and may thus face limited access to financing.

### c. Establishment process, documentation & costs

Similar to a 1LLC SE, a MLLC SE must register its establishment with the DPI of the city or province where its head office is located in accordance with applicable processes, procedures and application file prescribed in the LOE.

The application file must include (1) the registration application for establishment, similar to an application for a non-social enterprise MLLC, and (2) the commitment to implement the social and environmental objectives (Commitment) with details similar to that of a 1LLC SE.

The granting of the Enterprise Registration Certificate (ERC) and Investment Registration Certificate (IRC), if any, for a MLLC SE is similar to a 1LLC SE.

An existing MLLC can convert into an MLLC SE by sending a written notification of its commitment to implement its social and environmental objectives (i.e., the Commitment) to the DPI of the city or province where the head office is located. The DPI will update its conversion of the social enterprise on the National Business Registration Portal (NBRP).

The government fee for the ERC is VND 200,000 (approx. USD 8.70) and for declaration of contents of enterprise is VND 300,000 VND (approx. USD 13.05). The IRC is granted free of charge by the licensing authority.

There is no fee for the conversion of an existing MLLC to a MLLC SE.

#### **d. Liabilities**

The same regulations apply to social enterprises under all forms of business establishment. Please refer to our discussion in item 1.1(d) above.

#### **e. Tax Treatment**

The same regulations apply to social enterprises under all forms of business establishment. Please refer to our discussion in item 1.1(e) above.

#### **f. Ongoing Governance and Regulatory Obligations**

A decision on termination of the social or environmental objectives or revision of the Commitment must be passed by members representing at least 75 percent of contributed capital of attending members at the meeting of the members' council.

#### **Notification/reporting obligations**

These regulations apply to social enterprises under all forms of business establishment. Please refer to our discussion in item 1.1(f) above.

#### **Requirements on termination/dissolution/restructuring**

These regulations apply to social enterprises under all forms of business establishment. Please refer to our discussion in item 1.1(f) above.

#### **Member obligation/restriction on transfer of shares**

- A member of the MLLC SE (i.e., the owner) is only permitted to assign its capital contribution portions in the social enterprise to other organizations or individuals who undertake to continue to conduct the activities of the MLLC SE for social or environmental objectives; and
- A member of the MLLC SE (i.e., the owner) will be liable for the refund of the incentives, aid, and assistance received and to pay compensation for loss arising from breach of Commitment by the social enterprise.

#### **g. Corporate structure**

An MLLC SE must have a members' council, a chairperson of the members' council, and a director or general director. The members' council is the highest decision-making authority of the MLLC SE and will comprise all members of the MLLC SE. Under the LOE, a company, including an MLLC SE, may have multiple legal representatives but at least one legal representative must permanently reside in Vietnam.

An MLLC SE may also have an inspection committee, and if an MLLC SE has at least 11 members, an inspection committee is mandatory.

Members' council resolutions must be approved by votes representing at least 65 percent of the aggregate capital of the attending members, and a higher percentage may be stipulated in the charter of the MLLC SE.

Certain special decisions such as the sale of at least 50 percent of the assets of the MLLC SE, the amendment of the charter, or dissolution of the MLLC SE will require 75 percent approval.

#### **h. Governance**

There are regulations governing the board composition of the MLLC SE. As discussed in item (g) above, the members' council must include all members of the MLLC SE.

There are no restrictions on a foreign citizen sitting on the board.

#### **i. Finance & fundraising**

Funding and/or investment regulations are similar to those of a 1LLC SE. Please refer to our discussion in item (i) above.

Tax implications are also similar to those of a 1LLC SE. Please refer to our discussion in item (e) above.

## **LEGAL STRUCTURE 3 – SOCIAL ENTERPRISE UNDER THE FORM OF A SHAREHOLDING COMPANY (SC)**

### **a. Overview**

Similar to a conventional SC, a social enterprise in the form of an SC (SC SE) is an enterprise in which the charter capital is divided into equal portions called shares.

Shareholders may be organizations or individuals, with requirements for a minimum of three shareholders and no restriction on the maximum number of shareholders. A shareholder is liable for the debts and other property obligations of the SC SE only within the amount of capital it has contributed to the SC SE. With a few exceptions, shareholders may freely assign their shares.

### **b. b) Advantages & disadvantages**

#### Advantages

- ✓ An SC SE may issue ordinary shares and preferred shares.
- ✓ An SC SE may also issue bonds, convertible bonds, and other classes of bonds in accordance with the law and the charter of the SC SE.

#### Disadvantages

- ✗ Founding shareholders must collectively subscribe to at least 20 percent of the ordinary shares at the registration date of the enterprise.

### **c. Establishment process, documentation & costs**

#### **New establishment**

Similar to other forms of social enterprises, an SC SE must register its establishment with the DPI of the city or province where its head office is located in accordance with applicable processes, procedures and application file prescribed in the LOE.

The application file must include (1) the registration application for establishment of a non-social enterprise SC, and (2) the Commitment with details similar to other forms of social enterprises.

The granting of the Enterprise Registration Certificate (ERC) and Investment Registration Certificate (IRC), if any, for an SC SE are similar to other forms of social enterprises.

### Conversion of existing enterprise

An existing SC can convert into an SC SE by sending a written notification of its commitment to implement its social and environmental objectives (i.e., the Commitment) to the DPI of the province where the head office is located. The DPI will update its conversion of the social enterprise on the National Business Registration Portal (NBRP).

### Governmental costs

The government fee for the ERC is VND 200,000 (approx. USD 8.70) and for declaration of contents of enterprise is VND 300,000 VND (approx. USD 13.05). The IRC is granted free of charge by the licensing authority.

There is no fee for the conversion of an existing SC SE to an SC SE.

### d. Liabilities

Please refer to our discussion of liabilities for LEGAL STRUCTURE 1 at item (d) above.

### e. Tax Treatment

Similar to other forms of social enterprises. Please refer to our discussion for LEGAL STRUCTURE 1 at item (e) above.

### f. Ongoing Governance and Regulatory Obligations

#### Requirements on receipt of donation

Similar to other forms of social enterprises. Please refer to our discussion in item 1.1(f) above.

#### Corporate governance

An SC SE must hold a shareholders' meeting at least once a year and all such shareholders' meetings must take place in Vietnam. If a shareholders' meeting is concurrently held in multiple locations, the location of the meeting will be the location where the chairperson of the meeting attends.

The annual shareholders' meeting must take place within four months, or six months (if approved by the licensing authority), of the financial year-end.

The quorum for a shareholders' meeting is at least 51 percent of the total voting shares. Moreover, at least 51 percent of the voting shares present are required to pass a resolution. Resolutions on issues such as classes of shares, number of new shares to be offered, amendments to the charter, reorganization or dissolution of the SC SE, and sale of at least 50 percent of SC SE assets require 65 percent of the voting shares present.

A decision on termination of the social or environmental objectives, revision of the Commitment requires 65 percent of the voting shares present.

#### Notification/reporting obligations

Similar to other forms of social enterprises. Please refer to our discussion in item 1.1(f) above.

### Requirements on termination/dissolution/restructuring

Similar to other forms of social enterprises. Please refer to our discussion in item 1.1(f) above.

### Member obligation/restriction on transfer of shares

- Shareholders of the SC SE are only permitted to assign their shares to other organizations or individuals who undertake to continue to conduct the activities for social or environmental objectives.
- Shareholders of the SC SE are liable for the refund of the incentives, aid and assistance received and payment of compensation for loss arising from breach of Commitment by the social enterprise.
- Shares are freely assignable, except that during the first three years of the term of the ERC, all ordinary shares belonging to founding shareholders may only be transferred to other founding shareholders unless approved by a shareholders' meeting. These restrictions do not apply to additional shares obtained by founding shareholders after enterprise registration, or to shares transferred to non-founding shareholders with the approval of a shareholders' meeting, as mentioned above.
- Share buyback/redemption in an SC SE compulsorily results in charter capital decrease. However, this provision does not apply if otherwise stipulated in securities law. It thus appears that treasury shares are permitted in respect of public companies.

### g. Corporate structure

An SC SE may select either of the following organizational structures, unless otherwise stipulated in the Law on Securities:

- Structure 1: (1) General meeting of shareholders, (2) board of management, (3) inspection committee, and (4) director or general director. If the SC SE has fewer than 11 individual shareholders, and less than 50 percent of the total shares are held by organizations, it is not required to have an inspection committee.
- Structure 2: (1) General meeting of shareholders, (2) board of management, (3) internal audit committee, and (4) director or general director.

The internal audit committee in Structure 2 is a new option introduced in the LOE. This committee is under the board of management, but the LOE is silent on its specific rights and obligations as well as the criteria for its members. It is our understanding that the internal audit committee, to some extent, plays the same role as the inspection committee of Structure 1.

Under Structure 2, at least 20 percent of the members of the board of management must be independent members, who are subject to relatively high standards. For instance, an independent member may not directly or indirectly own 1 percent or more of the total voting shares, and cannot have been a member of the board of management or the inspection committee for at least the last five preceding years.

The chairperson of the board will be the legal representative of the SC SE unless the charter specifies otherwise. An SC SE must have at least one legal representative permanently residing in Vietnam. If the SC SE has more than one legal representative, both the chairperson of the board and the director or general director will be legal representatives of the SC SE.

**h. Governance**

There are regulations governing the board composition of the SC SE. The board of management must have from three to eleven members subject to the detailed stipulation under the charter.

The office term of each member is five years and members can be re-appointed.

There are no restrictions on a foreigner sitting on the board.

**i. Finance & fundraising**

Funding and/or investment permitted are similar to other forms of social enterprises. Please refer to our discussion of LEGAL STRUCTURE 1 at item (i) above.

Tax implications are similar to other forms of social enterprises. Please refer to our discussion of LEGAL STRUCTURE 1 at item (i) above.

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## LEGAL STRUCTURE 4 – HYBRID / MULTIPLE STRUCTURES

It is not advisable for a social enterprise to have more than one legal form. Incentives are already provided to social enterprises regardless of the legal form of business establishment.

## TRANSITIONING BETWEEN LEGAL FORMS

An organization that is currently registered as a charity/NGO may transition to a social enterprise model. At present, a social relief establishment, social fund, or charitable fund is permitted to convert itself into a social enterprise upon a written approval of the competent authority, which is normally the authority that approved their establishment. In this case, a new social enterprise will, after conversion, automatically be entitled to all lawful rights and interests, and will be liable for all obligations such as debts, taxes, or the like, of its previous non-social enterprise form.

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