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Australia

Ettiene Lawyers

Austria

Kraft & Winternitz Rechtsanwälte

# Etienne Lawyers

Australia

📍 Level 56 MLC Centre, 19-29  
Martin Place, NSW 2000  
Sydney - Australia

☎ +61 28 8452400

☎ +61 02 9383 8202

✉ info@etiennelaw.com

🌐 www.etiennelaw.com

**Etienne Lawyers**  
helps our clients to:

- reduce risk
- save money
- save time
- get good deals done.

## Thinking of Establishing a Business in Australia?

Australia is a dynamic and strong economy in which to establish operations. Being in the Asia – Pacific region you can use a business in Australia as the staging post for doing business in Asia and throughout the Pacific. Some of the issues to consider in deciding whether to establish a business in Australia are discussed in the brochure.

## Accounting Records

Where statutory accounts are not required the directors are still required to maintain accurate accounting records in order to explain the branch's financial transactions and financial position to enable statutory accounts to be prepared if required. Management accounts are necessary for tax and management purposes and to meet the director's obligation to ensure the branch can meet debts as and when they fall due.

## Withholding Tax

Currently withholding tax is required to be deducted from overseas payment of interest, unfranked dividends and royalties. Under business tax reform it is proposed to extend withholding tax to other types of income and capital gains.

## Customs and indirect taxes

**Goods and Services Tax.** Australia introduced a 10% Goods and Services tax (GST), on 1st July 2000. GST will be payable on the tax exclusive price of most goods and services supplied within Australia.

GST is also generally payable on the importation of goods. Registered suppliers will obtain a credit for GST paid on most inputs (purchases), subject to certain exemptions.

A registered business must lodge GST returns either monthly or quarterly via a Business Activity Statement (BAS, discussed later). Companies with taxation year-ends other than 30th June must lodge the BAS monthly. The net GST liability (GST minus input tax credits) is paid to the Australian Taxation Office at the same time.

Some supplies, such as financial supplies and residential rent, are "input taxed". Input taxed supplies are not subject to GST. However the supplier is liable for GST on their inputs and is not entitled to a refund of the input tax. There is also a limited range of GST free supplies where GST is not required to be charged, however, the supplier is entitled to a refund of input tax.

There is also a GST deferral system, which can be vital if cash flow is critical. Essentially, GST can be deferred from the time of importation into Australia until the goods are sold.

**Customs Duties.** The Australian Government imposed on goods, imported into Australia, a customs duty. It is based on international customs agreements. This duty is generally imposed as an anti-dumping instrument and to provide protection for domestic manufacturers and wholesalers.

Customs duty is imposed on most goods at the rate of 5%. An exemption may be provided for goods, which are not subject to Australian competition.

## Employee Issues

**Payroll Tax.** Payroll tax is levied in all States and Territories on the employer's payroll, including non-cash benefits that vary from State to State.

Related companies and companies sharing employees are grouped together to determine tax threshold. Please advise if you are aware of any associated companies in Australia. Payroll Tax is levied on wages, usually at 6.2%, on the excess of "wages" over \$750,000 p.a. Thresholds and rates vary from state to state.

### Fringe Benefits Tax (FBT)

The Federal Government taxes employers on the value of certain non-cash benefits provided to employees, such as provision of a motor vehicle, payment of private expenses, the provision of rent free accommodation, interest free loans etc.

In effect employers pay the employees income tax on fringe benefits. Accordingly, before negotiating an employee's package you should ensure that you are aware of the full cost of the package, including FBT, the employer. There are opportunities to package expatriate employees remuneration to minimise FBT and income tax.

### Workers Compensation

Employers are required to carry workers' compensation insurance in order to protect its employees. As soon as staff arrive in Australia workers' compensation insurance must be taken out in each State/Territory the branch has employees.

### Superannuation Guarantee

Employees must pay superannuation to a complying fund based upon 9.5% of the employee's wages.

There are limited exemptions to this requirement. If an employer fails to pay the required amount they are subject to a charge (SGC), which is paid to the Australian Taxation Office. There are penalties associated with this breach.

### PAYG withholding tax collections

Employers are required register with the Australian Taxation Office and withhold and subsequently remit via the monthly BAS to the Australian Taxation office the income ax payable by employees on their salary. The tax collected by the employer is known as Pay as You Go (PAYG) withholding.

There are substantial penalties for failing to register or deduct the appropriate level of tax or for late payment to the Australian Taxation Office.

### Business Activity Statement

Most taxes collected or payable by a business must be aggregated and paid to the ATO either monthly or quarterly. The business must lodge a Business Activity Statement to record each tax paid. That is, splitting aggregated payments up into Income Tax (instalments), Pay as You Go withholdings, FBT, GST, etc.

To complete the BAS the company must keep up to date records of income and expenditure. The records should be designed to provide the required information for the BAS as well as to meet your internal reporting requirements. Hall Chadwick can provide a BAS service.

### Thin Capitalisation

Commonly referred to as "thin capitalisation" includes a complex set of rules, which govern the income tax deductibility of interest paid by an Australian enterprise. The object of the thin capitalisation rules is to reduce or eliminate a tax deduction for interest paid or accrued on debt if the permissible ratio of debt to assets exceeds 75%. This ratio is known as the "safe harbour" ratio.

Notably, a "de minimis" exemption has been enacted in the new legislation from 1st July 2001. Essentially, the new rules will only affect entities if the total debt deductions (basically interest) exceed \$250,000 in a financial year. Regardless of the Thin Capitalisation rules applying, withholding tax of 10% on interest payments would be applicable.



## Structuring

The choice of business structure depends upon your requirements. Being a common law nation the usual forms of business structure are available:

- Sole Trader
- Partnership
- Corporation
- Joint Venture
- Trusts

Besides having separate legal entity established to operate your business in and from Australia by any of the usual forms of business structure you may consider the use of a Permanent Establishment.

## Our expertise covers

With Etienne Lawyers, you enjoy the expertise of a top-tier law firm but with the personalised service typical of a smaller firm.

Our practitioners have a proven record of delivering superb legal services to a wide range of commercial clients, from small business to some of the largest businesses in the world. Examples of their experience include:

- Procter & Gamble transactions including: the Acquisition of Max Factor cosmetics (US\$1.4 billion); the Acquisition of Clairol hair care products (US\$1.5 billion); the worldwide Divestiture of Nipasin (amount not for public disclosure); and the Divestiture of Milton (amount not for public disclosure)
- Indonesian Reconstruction Bank restructuring of the Texmaco Group involving US\$3.9 billion of assets
- Richard E Jacobs Group Inc sale of nine US shopping centres to Westfield America Trust Ltd for US\$1.5 billion .
- In addition, and reflecting their expertise, our team have lectured on Doctorate and Masters courses in Securities Law at UTS, Macquarie University, Notre Dame and for Finsia.

Corporate and commercial services; Mergers, acquisitions and disposals; Employment and industrial relations, Technology and intellectual property; Shareholder agreements; Litigation and alternative dispute resolution; Securities regulation; Foreign investment review board matters; Commercial agreements; Trade practices issues; Corporate governance and internal audits; Business succession planning; Property and conveyancing; Estate planning and wills; Personal legal services

## Sponsored Temporary Business Visas

In most instances the Long-Stay Business visa, known as the sub-class 457 visa, is the most appropriate. This visa entitles the visa holder to remain and work in Australia for a period of up to 4 years. Each family member receives the same visa and therefore spouses are permitted to work.

There are three stages in the 457-visa application process. The first stage is Sponsorship. In this stage the prospective employer is required to establish that it is lawfully operating a business in Australia and that it will be the direct employer of the prospective employee. It is required to demonstrate that it is sufficiently viable to support certain undertakings that are to be given to the Department. Such undertakings include the undertaking that the sponsor will be primarily responsible for medical expenses incurred by the employee and family members whilst in Australia. This undertaking could of course be insured.

At the application stage, the sponsor may apply for either a Standard Business Sponsor status or that of a Pre-qualified Business Sponsor. This decision would depend upon whether or not it is intended to employ substantial number of personnel within a two-year period. The Regulations also permit a business, which is not yet established in Australia to sponsor.

State two is the Nomination stage. At this stage, the nature of the position and salary package is provided. Only certain positions may be the subject of Nomination. A list has been gazetted for this purpose. Stage three is the application for the visa itself. At this stage the applicant is required to establish that he/she has the qualifications and experience required to fill the relevant position.

In practice, the Sponsorship and Nomination applications are filed together. In many instances, the visa applicant is onshore, in which case all three applications are lodged together (provided that the employee does not have any condition on his visa prohibiting onshore application). In this event the applicant may change status without leaving Australia.

Applications are dealt with expeditiously if fully presented. Consideration could also be given to Regional Headquarter Arrangements, which will provide substantial flexibility. Permanent visa applications have different rules again.

## Permanent Establishment

A foreign corporation will be taxed in Australia if a Permanent establishment exists. Situations where a Permanent Establishment will be triggered include where a branch operates in Australia. However, there are certain exemptions from this broad generalization.

A Permanent Establishment would be avoided where sales were effected by an independent agent. Conversely, a dependent agent arrangement would exist where the agent would habitually enter into contracts on behalf of the foreign corporation, having the power to enter in and accept contracts. In this case, a Permanent Establishment would exist of the foreign Corporation. Where a foreign company cannot claim a deduction for Australian costs in an initial start up period, it may be advisable to trigger a Permanent Establishment. Naturally, where a subsidiary operates in its own right, it will be regarded as a resident of Australia and taxed on profits it derives.

## • Regulations

The incorporation and regulation of corporations is governed by:

- The Corporations Act 2001 (Commonwealth);
- The common law; and
- Legislation dealing with specific issues including restrictive trade practices, consumer protection, employment practices, occupational health and safety, taxation and foreign investment.

## • Types of Companies

Of the common forms of trading corporations there are:

- Publicly listed corporations which are also regulated by the Australian Securities Exchange Ltd (ASX) listing rules.
- Public corporations that choose not to list on the ASX.
- Proprietary limited corporations.

The difference between the corporations is summarized in the table below:

Issue / Type	Publicly Listed	Public Not Listed	Proprietary Corporation
Minimum Number of Directors	3	3	1
Minimum Number of Shareholders	1	1	1
Maximum Number of Shareholders	None	None	50
Min. Number of Company Secretaries	1	1	Secretary Optional
Ability to raise capital from the public	Yes	Yes	No
Auditor	Must be appointed	Must be appointed	Optional
Must Comply with ASX Listing Rules	Yes (Requirement of ASX Listing Rules)	No	No
Independent	Yes (Requirement of ASX Listing Rules)	Optional	Optional
Directors	of ASX Listing Rules)		

## • Liability of Shareholders

The liability of shareholders of the above types of company is limited in each instance to the amount paid or agreed to be paid on the shares allotted to the shareholder.

## • Share Capital

Companies in Australia are not required to have a minimum amount of paid-up capital. The concept of par values for shares has been removed under the Corporations Act 2001.

## • Classes of shares

Shares can be issued as order, preferred or bearer shares.

## • Corporate Governance

### SHAREHOLDERS MEETINGS

Decisions reserved to the Shareholders:

<b>Powers reserved To Shareholders</b>	<b>Publicly Listed</b>	<b>Public Not Listed</b>	<b>Proprietary Corporation</b>
Increasing Share capital	Yes	Generally Yes but depends on Constitution	Generally Yes but depends on Constitution and any Shareholders Agreement
Changing the Corporate purpose	No	No	No
Reducing share capital	Up to a point, No, but once the point is reached shareholder approval is required	Up to a point, No, but once the point is reached shareholder approval is required	Up to a point, No, but once the point is reached shareholder approval is required
Change of Name	Yes	Yes	Yes
Authority to Bind company	No	No	No
Authority to Bind or require directors to act in a particular manner or refrain from acting	No	No	No
Right to remove directors	Yes	Yes	Yes
Right to transfer shares to third parties	Yes	Yes	Only with approval of the board of directors and (also) usually the other shareholders
Change of Constitution	Yes	Yes	Yes

### MINIMUM NUMBER OF SHAREHOLDERS MEETINGS/YEAR

- Public companies must convene one shareholders meeting every year.
- Proprietary companies may have shareholders meetings as and when required; there is no minimum number to be held in any year.
- A Director may request convening a shareholders meeting.
- Shareholders may request the board to convene a shareholders meeting and if the minimum number of shareholders so request a meeting must be convened.

## DIRECTORS

- **Appointment of Directors:** Directors are appointed by the votes of shareholders.
- **Powers of Directors:** Generally the power of day-to-day control of the company vests in the directors. The directors' power is absolute; save for the right of shareholders to remove directors who they think are not acting in the best interest of the company.
- **Minimum number of independent Directors:** At least one.
- **Term of appointment:** No statutory term, depends on the Constitution of the Companies. Shareholders have reserved powers to seek to remove directors at any time provided certain requirements under the law are met.
- **Requirements concerning directors' fees:** Listed Public Companies must disclose the remuneration paid to directors. Other companies do not have to disclose and generally never disclose the remuneration paid to directors.
- **Directors' liability:** Directors can be personally liable for the debts of companies if they allow the company to incur a debt, the company is liquidated and the court determines that the directors knew or ought reasonably to have known that the company was insolvent at the time the debt was incurred. In serious situations directors can be jailed for this offence.

## • Annual Accounting Procedures

### ▶ Necessary Documents

*The Corporations Act 2001 does not specify what documents or information if any a company must have. Directors are under a general duty to ensure that the financial accounts of the company are true and correct at all times.*

### ▶ Deadline for delivery of documents

*Public companies must file annual returns with copies of accounts within 6 months of the end of the company's financial year. The financial year in Australia is from 1 July each year to the following 30th June. Most listed public companies have to file and hold shareholders meetings by 31 December each year. Some companies have different financial years, as subsidiaries of foreign corporations whose year-end is different than that in Australia. Permission to have a different year-end for a company's financial year must be given by the Australian Taxation Office.*

### ▶ Statutory Audit

**Scope:** Public companies must be audited each financial year. The Auditor must report to the shareholders and to the Australian Securities and Investment Commission if any accounting irregularities are uncovered.

**Competence:** Auditors must be registered. An Auditor once appointed cannot be removed by the company. An Auditor may resign but cannot be removed without the approval of shareholders and then only upon the appointment of a replacement auditor.

## • Other Investment Structures

Besides the use of corporations as investment vehicles overseas investors can choose from other forms of investment vehicles. Below is a table of the forms of alternate investment vehicles. The choice of investment vehicle will be dependent upon tax, control and risk return considerations.

<b>Type of Entity</b>	<b>Nature</b>	<b>Governing Law</b>	<b>Legal Status</b>
Company	Complex and expensive	Corp Law common law Memorandum and articles of association Other statutes	Separate continuing entity Perpetual succession
Incorporated Association	Relatively simple and inexpensive	State Association Incorporation Acts Rules of association	Separate legal entity Perpetual succession
Co-operative	Potentially complex but inexpensive	State co-op legislation Rules of the co-op	Separate legal entity Perceptual succession
<b>Type of Entity</b>	<b>Nature of Administration and Costs</b>	<b>Governing Law</b>	<b>Legal Status</b>
Sole Trader	Simple but relatively inflexible	Dependent upon nature of business	Separate continuing entity No separate legal entity from individual owner No perpetual succession
Partnership	Simple and flexible	State Partnership Acts Common law Partnership agreement	No separate legal entity (except under certain Acts) No perpetual succession
Join Venture	Simple	Dependent upon nature of venture	Separate legal entity Perceptual succession if joint venture is formed by a company
Trust	Usually complex	State trustee acts Common law Equity	Equitable no legal recognition

Features	Method of Control	Liability	Summary of Advantages	Summary of Disadvantages
Various company structures	Board of directors	<b>Members:</b> usually limited to the amount unpaid and/or guaranteed on shares <b>Officers:</b> statutory and common law	limited liability Separate, consulting entity Member rights Company tax rates Simplification bills	Formalities Expense Statutory reporting requirements Directors' duties (statute and common law)
Non-profit	Committee	Limited	Separate continuing entity Tax exemptions Ability to convert into a company	No profit distribution Charitable and non-profit aims only
Co-operative principles	Democratic control Board of directors	Limited (subject to rules)	Equitable division of surplus Co-operative education, etc Democratic rule Voluntary open membership	Directors' duties Formalities Compulsory dealings Record-keeping requirements
Features to Consider	Method of Control	Liability for Losses	Summary of Advantages	Summary of Disadvantages
Tax advantages disadvantages	Sole control by trader	Unlimited personal liability	Simple, inexpensive Absolute control	Unlimited personal liability Finance raising No continuity
	Partner own and control the business	Unlimited personal liability	Income-splitting tax advantages Share profits	Transferring interests Limited size
One-off activities Share of product not profit	Pursuant to joint venture agreement	Joint and several liability	Simple to expand Non-fiduciary	No sharing of profit Separate sale of product Finance Raising
Rights enforced in equity not law Rights non-contractual	Trustee (subject to fiduciary obligation)	Trustee personally liable (but usually right of indemnity exists)	Tax advantages Simple sale of assets Flexibility	Complex and technical No community of existence at law

# Australia | TAX LAW

The Australian income tax system is a federal system based on the Income Tax Act and other related acts. The income tax year is 12 months ending 30 June (unless substituted accounting period granted).

Income tax, which is by far the most significant tax levied in Australia, is imposed only by the Commonwealth Government. There are no separate State or Territory income taxes. Instead, the States and Territories raise some of their revenue through other taxes such as pay-roll tax, land tax, stamp duty and financial transactions tax. The balance of their revenue consists mainly of grants from the Commonwealth Government.

In addition to income tax, the Commonwealth Government also imposes a variety of other taxes including fringe benefits tax (on employee benefits), wholesale sales tax (on goods), customs and excise duties, superannuation guarantee surcharge and petroleum resource rent tax.

Local authorities also raise revenue from rates and taxes imposed on landholders living or carrying on business in the local authority area.

Australia does not currently have a value added tax, and has neither wealth, death nor gift taxes.

- **Income tax**

Australia's income tax system is administered by the Australian Taxation Office (ATO), which is headed by the Commissioner of Taxation.

Australian income tax is levied on both the income and the capital gains of all individuals and companies and certain other entities such as limited partnerships and certain trusts. Unlimited partnerships are taxed at the individual partner level.

Broadly, residents of Australia are liable to income tax in respect of their worldwide income, while non-residents are liable to income tax in respect of their income from Australian sources. This broad principle is subject to the provisions of any bilateral double taxation treaty entered into between Australia and almost 40 other countries. Treaties generally follow the OECD Model Convention.

## TAXABLE INCOME

Income tax is payable in respect of “taxable income,” which is calculated by deducting from assessable income all allowable deductions. Taxable income is calculated on an annual basis, with the year of income being a fiscal year ending on 30 June, unless the Commissioner has given permission for the taxpayer to adopt a year of income ending on some other date, which is often the case for Australian subsidiaries of foreign-based entities.

Most expenditure incurred in deriving assessable income is deductible in calculating taxable income, either in the year in which it is incurred, or amortized over a period of years, or at the time of disposal of a capital asset in respect of which a capital gain arises.

State and local taxes are generally allowable deductions in calculating the taxable income upon which federal income tax is levied, unless they form part of the cost of a capital asset, such as stamp duty on the transfer of land.

Losses can be carried forward indefinitely but cannot be carried back. Losses incurred by companies and certain other entities are subject to satisfaction of the majority continuity of ownership rules or, failing that, the same (identical) business rules.

## INCOME TAX RATES

Income tax is levied on both resident and non-resident individuals on a progressive basis, with the highest rate of 45%. Resident individuals also pay an additional 1.5% of taxable income by way of Medicare levy.

## RESIDENT INDIVIDUALS

Resident individuals whose total taxable income for the year from all sources (regardless of whether it originates in or out of Australia) exceeds the tax-free threshold of AUD \$18,200 are required to file an Income Tax Return. Individuals as well as all other taxpayers must have a Tax File Number.

The net tax payable is computed by deducting from the gross tax: any rebates (e.g. for dependents, sole parent, housekeeper, pensioner, zone allowance, low income earner, net medical expenses in excess of AUD 1,250, franking credits etc.) and any other credits (e.g. for foreign taxes).

For taxable incomes over AUD \$21,655 for the 2016/17 year an amount for the Medicare Levy must be added equal to 2% of the taxpayer's taxable income (unless an exemption or reduction applies). The levy is collected in conjunction with, and in the same way as, income tax.



To arrive at the actual tax payable, the net tax payable will generally need to be adjusted by deducting prepaid tax (whether by tax installment deductions withheld from salary by an employer or by Pay As You Go installments paid).

## INDIVIDUAL TAX RATES

The individual rates for Residents of Australia the 2017–2018 tax year are:

### ► Tax rates 2017-18

*The following rates for 2017-18 apply from 1 July 2017.*

Taxable income	Tax on this income
0 - \$18,200	Nil
\$18,201 - \$37,000	19c for each \$1 over \$18,200
\$37,001 - \$87,000	\$3,572 plus 32.5c for each \$1 over \$37,000
\$87,001 - \$180,000	\$19,822 plus 37c for each \$1 over \$87,000
\$180,001 and over	\$54,232 plus 45c for each \$1 over \$180,000

The above rates do not include the Medicare levy of 2% (read Guide to Medicare levy for more information).

### ► Foreign residents

*If you are a foreign resident for the full year, the following rates apply:*

**Tax rates 7.** The following rates for 2017-18 apply from 1 July 2017.

Taxable income	Tax on this income
0 - \$87,000	32.5c for each \$1
\$87,001 - \$180,000	\$28,275 plus 37c for each \$1 over \$87,000
\$180,001 and over	\$62,685 plus 45c for each \$1 over \$180,000

Foreign residents are not required to pay the Medicare levy.

### ► Company Tax Rate

*From the 2016–17 income year, the small business company tax rate has been reduced to 27.5%. This lower rate must be applied by small businesses with a turnover (aggregated turnover) less than \$10 million that are:*

- companies
- corporate unit trusts
- public trading trusts.

*The company tax rate will remain at 30% for all other companies that are not small business entities.*

*For the 2015–16 income year, the small business company tax rate was 28.5% for companies with a turnover less than \$2 million and 30% for all other companies. Previous to this, it was 30% for all companies.*

*There is no separate branch profits tax for non-resident companies.*

## • Treatment of Dividends

Australia no longer has a classical system for corporate taxation. An imputation system for the taxation of company dividends operates in Australia, with resident individual shareholders being entitled to a credit (but no refund) for Australian tax paid by a company. Dividends which attract the credit are called “franked dividends”. Other dividends are called “unfranked dividends”.

Excess franking credit entitlements cannot be carried forward or carried back.

## • Withholding Tax

Certain income (interest, dividends and royalties) paid to non-residents may be subject to Australian withholding tax, irrespective of source. Withholding tax is a first and final tax imposed on the payee but collected from the payer of the income to which it applies.

The withholding tax is subject to treaty limitations but generally ranges between 10% (interest and royalties) and 30% for dividends (15% for treaty dividends).

No withholding tax is payable in respect of fully franked dividends paid by a resident company to a non-resident shareholder.

## • Capital Gains and Losses

Capital gains derived on the disposal of assets acquired or deemed to have been acquired on or after 20 September 1985 are subject to tax in Australia. Subject to minor concessions for individual taxpayers, the capital gain is included in assessable income and taxed at the same rate as any other income derived by the taxpayer.

In calculating the capital gain derived on the disposal of an asset, the cost of the asset is indexed for inflation over the period during which it has been held by the taxpayer.

Capital losses can only be offset against capital gains, either in the current year of income or in a future year of income. Capital losses cannot be carried back. For non-residents, there are special rules which limit the operation of the capital gains provisions to certain specified types of assets. Gains on other types of assets are generally not taxable. As usual, these provisions are subject to the terms of any relevant double taxation treaty.

- **Intra-company Group Relief**

Generally dividends paid by one resident company to another, although representing assessable income, are not taxable due to rebate provisions. Care must be exercised by the Australian dividend recipient to ensure otherwise allowable deductions are not offset against effectively tax-free dividend income.

Resident companies which are 100% related may transfer losses if they elect to do so. There is no consolidated tax return as such.

Roll-over relief is available for 100% related companies (including non-resident companies in certain circumstances) whereby tax on capital gains may be deferred.

- **Income Tax Issues for Foreign Investors**

Australia has thin capitalization rules which disallow excess interest deductions where the debt to equity ratio of non-financial institutions owned by non-residents exceeds 2:1. For financial institutions, the permitted ratio is 6:1.

Australia has transfer pricing rules which apply to international transactions. The rules apply not only to related parties but also to unrelated parties.

Australia has unusual rules that prevent a foreign investor replacing equity with debt in specific cases involving the sale of in-house assets.

Payments to non-residents under hire-purchase agreements are treated as the payment of royalties subject to withholding tax, rather than as a sale and loan arrangement.

- **Other important taxes**

According to the fringe benefits tax (FBT) legislation, a fringe benefit is a benefit provided in respect of employment. This effectively means a benefit is provided to somebody because they are an employee. The 'employee' may even be a former or future employee.

FBT is imposed on a range of benefits provided by an employer to their employees.

The FBT year is 12 months from 1 April and ending 31 March in the succe-

eding year. The rate may vary. For example as at 1 April, 2011 the rate was 46.5% of the grossed-up value of the benefit. Both the cost of the benefit and the fringe benefits tax are deductible in calculating taxable income. In 2006 the rate was 48.5%.

A fringe benefit is a 'payment' to an employee, but in a different form to salary or wages.

An employee is a person who is entitled, or has been entitled, to receive salary or wages. Benefits provided in respect of someone who has died are not fringe benefits as a deceased person does not meet the definition of 'employee' in the FBT legislation.

The terms benefit and fringe benefit have broad meanings for FBT purposes. Benefits include rights, privileges or services. For example, a fringe benefit may be provided when an employer:

- Allows an employee to use a work car for private purposes
- Gives an employee a cheap loan
- Pays an employee's gym membership
- Provides entertainment by the way of free tickets to concerts
- Reimburses an expense incurred by an employee, such as school fees
- Business lunches and drinks, cocktail parties and staff social functions
- Providing entertainment to employees and clients by providing access to sporting or theatrical events, sightseeing tours, holidays and so on
- Accommodation and travel when it is provided in connection with, or to facilitate, activities such as entertaining clients and employees over a weekend at a tourist resort, or providing them with a holiday
- Gives benefits under a salary sacrifice arrangement with an employee.

Pay-roll tax is imposed by the States and Territories on wages paid by employers to employees. The rate varies between the States and Territories, but ranges between 3.95% and 7%.

Stamp duty is also imposed by the States and Territories on a range of written instruments and also on some transactions. The rate varies between the States and Territories and also depends upon the type of transaction or the type of property transferred by the written instrument. For example, in relation to transfers of land, duty of up to 5.5% of the value of the land may be imposed. Transfers of shares are taxed at lower rates (between 0.3% and 0.6%), except where the underlying assets consist primarily of land, where the land rate applies.

Land tax is imposed on the unimproved capital value of land owned in the six States and the Australian Capital Territory.

# Australia | FOREIGN INVESTMENT

Foreign investment activities in Australia are regulated at the Commonwealth level by the Treasurer, as advised by the Foreign Investment Review Board (FIRB) and the Department of Treasury, pursuant to the Foreign Acquisitions and Takeovers Act, 1975 and policy guidelines.

In general foreign investment is encouraged and while notification is required rarely is the power to refuse the investment made by the Treasurer.

The scheme of the Act is to require compulsory notification of certain proposed acquisitions of Australian assets, and to make other proposed or completed acquisitions and arrangements subject to prohibition or divestiture after they have been examined and found to be contrary to the National interest (without requiring notification).

- **Investing in an Australian Business**

The Government screens foreign investment proposals to ensure they are not contrary to Australia's national interest.

In general, proposals to acquire an interest of 20 per cent or more in any business valued at over \$252 million (or the higher threshold of \$1,094 million for agreement country investors from Chile, China, Japan, Korea, New Zealand and the United States) require prior approval.

All foreign government investors also require approval to acquire a direct interest in an Australian entity or an Australian business or to start a new Australian business, regardless of the value of the investment (\$0 threshold).

The Treasurer can prohibit foreign investment proposals found to be contrary to the national interest, or can impose conditions on an investment to address national interest concerns.

## **BUSINESS EXEMPTION CERTIFICATE**

On 1 July 2017, the Foreign Acquisitions and Takeovers Regulation introduced the business exemption certificate for programs of acquisitions of interests in the assets of an Australian business and/or securities in an entity, including interests acquired through the business of underwriting.

## • Investing in an Australian Agricultural Venture

Proposed direct interests in an Australian Agricultural Venture (an “agribusiness”) generally require approval where the value of the investment is more than \$55 million, with an exemption applying to investors from Australia’s trade agreement partners and a \$0 threshold applying to Foreign Government investors.

Section 12 of the Regulation defines an Australian entity or Australian business to be an agribusiness when the following two circumstances are met.

What is an agribusiness?

► **The Australian entity or Australian business uses assets in carrying on a business wholly or partly, in any of the following industries:**

- Any class of Division A – Agriculture, Forestry and Fishing
- Meat processing
- Poultry processing
- Seafood processing
- Milk and cream processing
- Cheese and other dairy product manufacturing
- Fruit and vegetable processing
- Oil and Fat manufacturing
- Grain mill product manufacturing
- Sugar manufacturing

► **Either:**

- For an Australian entity:

a. The value of the assets of the entity and subsidiaries of the entity, used in carrying on an agribusiness exceeds 25 per cent of the total asset value of the entity

b. The earnings before interest and tax derived by the entity and its subsidiaries in the above classes in the most recent financial year for which there are audited accounts, exceeds 25 per cent of the total earnings for the entity

- For an Australian business, the value of the assets of the business used in carrying on an agribusiness exceeds 25 per cent of the value of the total assets of the business.

### AGRICULTURAL LAND

Proposed investments in agricultural land generally require approval where the cumulative value of a foreign person’s agricultural land holdings exceeds \$15 million, with exceptions applying to investors from Australia’s trade agreement partners and a \$0 threshold applying to Foreign Government investors.

All acquisitions of interests in agricultural land by foreign persons regardless of whether they require approval and regardless of value must be notified to the Australian Taxation Office Register of Foreign Ownership.

► **What is agricultural land?**

*Agricultural land is land in Australia that is used, or that could reasonably be used, for a primary production business. This includes land which is partially used for a primary production business, or land where only part of the land could reasonably be used for a primary production business.*

*The definition of a primary production business is the same the definition in subsection 995-1(1) of the Income Tax Assessment Act 1997.*

- Cultivating or propagating plants, fungi or their products or parts (including seeds, spores, bulbs and similar things), in any physical environment
- Maintaining animals for the purpose of selling them or their bodily produce (including natural increase)
- Manufacturing dairy produce from raw material that you produced
- Conducting operations relating directly to taking or catching fish, turtles, dugong, bêche-de-mer, crustaceans or aquatic molluscs
- Conducting operations relating directly to taking or culturing pearls or pearl shell
- Planting or tending trees in a plantation or forest that are intended to be felled;
- Felling trees in a plantation or forest
- Transporting trees, or parts of trees, that you felled in a plantation or forest to the place:
  - a. Where they are first to be milled or processed
  - b. From which they are to be transported to the place where they are first to be milled or processed.

► **Exemptions for wind or solar power stations**

*The thresholds for agricultural land do not apply to certain acquisitions of agricultural land by owners or operators of wind or solar power stations. A "wind or solar power station" is defined in section 5 of the Foreign Acquisitions and Takeovers Regulation 2015 to mean a wind power station or solar electricity generation system that is an accredited power station as defined in the Renewable Energy (Electricity) Act 2000.*

*Owners and operators of solar and wind power stations that acquire an interest in agricultural land on which there is a wind or solar power station, and their acquisition is for the sole purpose of operating a wind or solar power station on the land, can disregard that the land is agricultural land for the purposes of the Act. In such circumstances even if the land still meets the usual test for agricultural land it is treated as if it is not agricultural land for the purposes of screening and specified thresholds for the other type of land will apply. For example, if it is considered non-vacant commercial land then the applicable threshold for such land will apply.*

## • Commercial Real Estate

Foreign persons may be required to notify and receive a no objections notification before acquiring an interest in commercial land in Australia. Different rules apply depending on whether the land is vacant or not, whether the proposed acquisition falls into the category of sensitive commercial land that is not vacant, and the value of the proposed acquisition.

Commercial land means land in Australia (including any building on the land) or the seabed of the offshore area, other than land:

- Used wholly and exclusively for a primary production business
- On which the number of dwellings that could reasonably be built is less than 10
- On which there is at least one dwelling (except commercial residential premises)

### ► Vacant commercial land

*Commercial land is vacant if there is no substantive permanent building on the land that can be lawfully occupied by persons, goods or livestock.*

*Foreign persons generally need to notify before acquiring an interest in any vacant commercial land, regardless of the value of the proposed acquisition (\$0 threshold). No objections notifications will normally be subject to conditions that the foreign person:*

- Commences continuous construction of the proposed development on the land within five years of the date of approval
- Does not sell the land until construction is complete

### ► Developed commercial land

*Foreign government investors are required to notify before acquiring any interest in developed commercial land, regardless of the value (\$0 threshold) and their country of origin.*

*Foreign persons need to notify before acquiring an interest in developed commercial land only if the value of the interest is more than the relevant notification threshold. The general notification threshold for developed commercial land is \$252 million unless the proposed acquisition is considered to be sensitive, in which case the threshold is \$55 million.*

*If the foreign person is from an agreement investor country, the threshold is \$1,094 million regardless of whether the land is considered sensitive. Land on which the only dwellings are commercial residential premises is considered developed commercial land and includes:*

- A hotel, motel, inn, hostel or boarding house
- Premises used to provide accommodation in connection with a school
- A marina with berths occupied by ships used as residences
- A caravan park or camping ground
- Any other premises similar to those outlined under the GST Act, other than premises used to provide accommodation to students in connection with an education institution that is not a school

**Commercial residential premises** does not include retirement villages, aged care facilities and certain student accommodation.



## • Residential Land

The rules are different depending on the type of residential land being considered.

### ESTABLISHED RESIDENTIAL DWELLINGS

Non-resident foreign persons are generally prohibited from purchasing established dwellings in Australia.

An established dwelling is a dwelling (except commercial residential premises such as hotels, motels and caravan parks) on residential land that is not a new dwelling.

Temporary residents will normally be allowed to purchase only one established dwelling to live in as their residence (home) in Australia, subject to the conditions that they:

- Use the property as their principal place of residence in Australia
- Do not rent any part of the property, included ensuring that the property is vacant at settlement
- Sell the property within three months from when it ceases to be their principal place of residence

Temporary residents are not permitted to purchase established dwellings as investment properties, or rent out, or as holiday homes.

Foreign controlled companies are generally prohibited from purchasing established dwellings, although foreign companies with a substantial Australian business may be permitted to acquire established dwellings for the purpose of providing housing for their Australian based staff.

### NEW RESIDENTIAL DWELLINGS

Foreign persons generally need to apply and receive foreign investment approval before purchasing new dwellings. Applications to purchase new dwellings are usually approved without conditions.

A new dwelling is a dwelling that will be, is being, or has been built on residential land, has not been previously sold as a dwelling and has either:

- Not been previously occupied
- If the dwelling is part of a development, was sold by the developer of that development and has not previously been occupied for more than 12 months in total

New dwellings do not include established residential real estate that has been refurbished or renovated.

A single dwelling that has been built to replace one or more demolished established dwellings would generally not be considered a new dwelling for the purposes of Australia's foreign investment framework.

### VACANT RESIDENTIAL LAND

Foreign persons generally need to apply and receive foreign investment approval before purchasing vacant residential land for development.

Foreign persons will normally be allowed to purchase vacant land for residential dwelling development, subject to conditions that:

- The development is completed within four years from the date of approval
- Evidence of completion of the dwelling/s is submitted within 30 days of being received. This could include a final occupancy or builder's completion certificate.

Vacant residential land that previously has an established dwelling on the land would generally not be considered as vacant land for the purposes of Australia's foreign investment framework.

### REDEVELOPMENTS OF RESIDENTIAL LAND

Foreign persons (temporary residents and foreign non-residents) generally need to apply and receive foreign investment approval before purchasing established residential dwellings for redevelopment.

Foreign persons will normally be allowed to purchase an established dwelling for redevelopment in Australia, provided the redevelopment genuinely increases the housing stock. An increase in Australia's housing stock is generally taken to mean that at least one additional dwelling will be created.

Such proposals are normally approved subject to conditions that:

- The existing dwelling(s) must remain vacant prior to demolition and redevelopment
- The existing dwelling(s) is demolished and construction of the new dwelling is completed within four years of the date of approval
- Evidence of completed of the dwellings is submitted within 30 days of being received by the applicant. This could include a final occupancy or builder's completion certification

Foreign persons will generally not be given approval to purchase an established dwelling to redevelop into a single new dwelling.

## DEVELOPERS

Property developers and other vendors can apply for an exemption certificate to sell new dwellings in a specified development to foreign persons, without each foreign person purchaser being required to seek their own foreign investment approval (similar to what has previously been known as an ‘advanced off-the-plan’ certificate).

Developers (either Australian or foreign) can apply for a new dwelling exemption certificate provided that the development:

- Will consist of 50 or more dwellings
- Has development approval from the relevant government authority
- If applicable, that foreign investment approval was sought to purchase the land and that any conditions are being met.

Applications for a certificate will be considered on a case-by-case basis to ensure they are not contrary to the national interest.

The certificate, if granted, will normally be approved subject to conditions that the developer:

- Provide a copy of the Certificate to each prospective foreign purchaser
- Provide a report (timing defined by the certificate) which includes all of the information requested in the New Dwelling Exemption Certificate Report either:
  - a. By sending to *[firbresidential@ato.gov.au](mailto:firbresidential@ato.gov.au)*
  - b. By emailing *[firbresidential@ato.gov.au](mailto:firbresidential@ato.gov.au)* to request secure channel delivery
- Ensure that the Development is marketed in Australia.

## FAILED SETTLEMENTS

A Near-New Dwelling Exemption Certificate has been introduced for failed off-the-plan purchases in a development, which allows for developers to sell near-new dwellings in a similar way to new dwellings.

This fix is necessary because the Foreign Acquisitions and Takeovers Act 1975 defines a new dwelling as a property that has not been previously “sold”. A property is considered “sold” once a binding purchase agreement has been entered into regardless of whether the sale is completed (or settled). If a purchase is not completed the dwelling would no longer be covered by the New Dwelling Exemption Certificate as it is not a new dwelling.

A near-new dwelling is a dwelling in a development that has previously been “sold” although the sale was not completed and the developer is entering a new agreement to sell the dwelling.

A person may apply for a Near-New Dwelling Exemption Certificate if some or all of the dwellings in the development are or may be near-new dwellings.

## • Effect of Notification Under Section 25

When the Treasurer is given notification of an acquisition or a proposed acquisition, Section 25 imposes time limits within which the Treasurer must act. Where notification is given of a proposal, examination will normally be carried out in two stages:

- 1. Preliminary examination which must be completed within 30 days of receipt of notification: Section 25(2) and (3). Preliminary examination may result in the quick clearance of the proposal. Preliminary examination may also result in an interim order prohibiting implementation of the proposal for a period of up to 90 days.
- 2. Detailed examination will follow an interim order and must be completed within 90 days: Section 25(3). Detailed investigation will conclude with the clearance of the proposal (possibly subject to conditions) or with a prohibition order being made under the relevant provision.
- 3. Conditions must be notified to the person within 10 days of the Treasurer's decision. If the Treasurer raises no objections to a proposal or if he allows it subject to conditions, the proposal can then go ahead without the potential of a later order for divestiture: Section 25(2) and (3).

## • Fees

Foreign Persons are required to pay a fee for each application made or notice given under the Foreign Acquisitions and Takeovers Act 2015 (limited exceptions apply).

The statutory timeframe for making a decision will not start until the fee has been paid in full. Where one agreement covers more than one action, the single highest fee for those actions will apply. This does not include interests in residential land, where a separate fee is payable for each action.

Fees are increased annually by the increase in the consumer price index as at 1 July each year.

Transaction	(est) Fee (2017) AUD
Purchase of residential or farm land great than AUD\$1m	\$5,500.00
Acquisition of commercial land, mine or and Australian entity greater than AUD \$1 m	\$2,000.00
Acquisition of interests in Australian Business/entity less than AUD \$1 Billion	\$2,000.00

- **Repatriation**

Australia does not restrict the flow of Australian or foreign currency in or out of the country. However, certain reporting obligations must be met for amounts over AUD \$10,000 or foreign currency equivalent. Regulatory requirements for financial services.

In addition to the reporting obligations of movements for amounts over AUD \$10,000 or the foreign currency equivalent, money laundering is a criminal offence in Australia under the Anti-Money Laundering and Counter Terrorism Finance Act 2006 (Cth) (AMLCTFA).

Money laundering is where a person attempts to evade taxation obligations or attempts to smuggle funds for the purpose of funding acts of crime and/or terrorism. The heightened sense of awareness in recent years of terrorist activity and the use by criminal organizations of sophisticated financing techniques led to the enactment of the AMLCTFA in December 2006.

The AMLCTFA is intended to help reduce the risk of Australian businesses being misused for the purposes of money laundering, terrorism financing and/or tax evasion. The Act classifies entities that perform one or more of a so called 'Designated Service' as Reporting Entities.

A Designated Service can be the opening of a bank account, accepting deposits, making loans, supplying goods through a finance lease, issuing travellers' cheques, providing certain superannuation related services, issuing or accepting liability under life insurance policies, exchanging currency, placing or receiving bets and etc.

Amongst other obligations, the AMLCTFA requires a Reporting Entity to have in place an Anti-Money Laundering and Counter Terrorism Financing (AML/CTF) Program and implement processes that allow it to effectively monitor, review and update its AML/CTF Program.

- **Foreign personnel**

To work in Australia as opposed to invest without working, a person requires a visa. There are various forms of visa's that may be granted.

The Australian government's view is that "Working in Australia is a privilege, not a right. Most temporary visa holders have work rights, although some classes of visas only allow limited work rights."

An example of the types of visa's that can be sought are:

- Employer sponsored employees
- Professional and other skilled migrants
- Business people
- Specialist Entry
- Regional employment

The rules for visa entry are in a constant state of flux. Once a visa is granted certainty is assured. However the rules for obtaining a visa change often. Further information should be sought at the relevant time.

# Australia | LABOUR LAW

Since 1 January, 2010 the Labour laws in Australia rather than being State and Federal became solely Federal.

Employers and employees other than in Western Australia that were previously covered by state industrial relations systems because the employer is not a constitutional corporation, are now covered by the national industrial relations system established by the Fair Work Act 2009 (Cth).

Employers and employees in the national system have the same workplace rights and obligations, regardless of the state they work in. Features of the national industrial relations system include:

- A set of 10 minimum National Employment Standards (NES)
- Modern awards that apply nationally for specific industries and occupations
- A national minimum wage order (where it applies)
- Enterprise bargaining
- Protection from unfair dismissal.

Modern awards, together with the NES and the national minimum wage order, make up a new safety net for employees covered by the national workplace relations system. In summary, the NES involve the following minimum entitlements:

1. Maximum weekly hours of work - 38 hours per week, plus reasonable additional hours.
2. Requests for flexible working arrangements - allows parents or carers of a child under school age or of a child under 18 with a disability, to request a change in working arrangements to assist with the child's care.
3. Parental leave and related entitlements - up to 12 months unpaid leave for every employee, plus a right to request an additional 12 months unpaid leave, and other forms of maternity, paternity and adoption related leave.
4. Annual leave - 4 weeks paid leave per year, plus an additional week for certain shift workers.
5. Personal / carer's leave and compassionate leave - 10 days paid personal / carer's leave, two days unpaid carer's leave as required, and two days compassionate leave (unpaid for casuals) as required.
6. Community service leave - unpaid leave for voluntary emergency activities and leave for jury service, with an entitlement to be paid for up to 10 days for jury service.

- 7. Long service leave - a transitional entitlement for employees who had certain LSL entitlements before 1/1/10 pending the development of a uniform national long service leave standard.
- 8. Public holidays - a paid day off on a public holiday, except where reasonably requested to work.
- 9. Notice of termination and redundancy pay - up to 4 weeks notice of termination (5 weeks if the employee is over 45 and has at least 2 years of continuous service) and up to 16 weeks redundancy pay, both based on length of service.
- 10. Provision of a Fair Work Information Statement - employers must provide this statement to all new employees. It contains information about the NES, modern awards, agreement-making, the right to freedom of association, termination of employment, individual flexibility arrangements, right of entry, transfer of business, and the respective roles of Fair Work Australia and the Fair Work Ombudsman.

Labour laws in Australia have some unusual protections, for instance concerning holiday pay. In many States, employees are paid a bonus (“loading”) while on leave to compensate them for the additional costs incurred while being on holidays!

When considering establishing a business in Australia, it is essential to obtain detailed advice on the employment practices in the particular industry and location in which the business is to operate.

## • Employment Contracts

### CLASSES

Employees under employed under individual contracts although there are State and Federal Awards which specify that employees in particular industries are entitled to and **MUST** receive minimum standards of pay, hours of employment, health care, and periods of leave.

### COST OF DISMISSAL AND WRONGFUL DISMISSAL

Fair Work Australia deals with two main types of dismissal applications:

- Unfair dismissal
- Dismissal where there has been a breach of the ‘general protections’
- The dismissal was not a case of genuine redundancy
- The dismissal was not consistent with the Small Business Fair Dismissal Code, where the employee was employed by a small business

A small business is a business that employs fewer than 15 employees.



To make an unfair dismissal remedy application an employee must be:

- Covered by the national unfair dismissal laws
- Eligible to make an application

The application must be lodged within 14 days of the dismissal coming into effect. To be eligible to apply an employee must, amongst other things, have:

- Completed a minimum employment period of at least six months (one year in the case of a small business employee)
- Be covered by an award or agreement and earn less than \$142,900 a year (as from 1 July 2017).

## **EMPLOYMENT CONTRACTS FOR DIRECTORS**

There is no special regime for directors to be employed by the companies of which they are directors.

## **ENTERPRISE BARGAINING UNDER THE FAIR WORK ACT**

There are two ways in which an employer can contract with the employees. The first is by way of common law contracts of employment. The other way is by way of collective bargaining. Whilst the Fair Work Act makes it much easier for employees to call upon union assistance in the process of collective bargaining, there is no requirement for union involvement. It is not compulsory. An employer can collectively bargain with its workforce and arrive at an outcome supported by its non-unionised workforce provided the Fair Work Authority (established by the new legislation) approves the collective agreement.

Under the Fair Work Act, the vast majority of work agreements will come into existence by way of collective agreements. These will be made between employers and employees. Unions can be named as a party to the agreement. If a union is a named party to an agreement, then that organisation has rights and obligations under the agreement. The union can enforce the agreement in its own name without an effective member.

There are four types of collective agreements. The first is single business collective agreements.

### **► Single Business Collective Agreements**

*These will form the most common type of collective agreement whereby employees who fall within the scope of the agreement are covered by it and must be made only for a single business*

or part of a business. A 'single business' is defined to mean a 'business, project or undertaking' carried on by an employer.

For example, where two or more unrelated employers carry on a 'joint venture' they are to be treated as having a single business. It is also possible for two or more corporations that are 'related' within the meaning of the Corporations Act 2001 to be treated as a single business however it is not mandatory. Such corporations have the choice as to whether to make separate agreements or join together and make a single agreement.

Moreover, such agreements can include geographically distinct part of the 'single business' or 'a distinct operational or organisational unit within the single business'. Thus it is possible for an employer to have different agreements at different locations or indeed for different divisions at the same locations.

Such agreements face potential oversight by Fair Work Australia for the majority of orders. Protected action is available during the bargaining process by the parties to it. Noticeably, the Fair Work Act does not alter the concept of "protected action" vis a vis "unprotected action", three days notice of industrial action to be given by a party, and an application for a secret strike ballot to approve industrial action.

This can be formed as part of a union collective agreement as long as the relevant union (s) has one or more members at the company. It is open to an employer as to whom to choose to bargain with.

Conversely, an employee collective agreement can be made and be drawn up by employers and employees and as with union collective agreements must also be approved by a majority of employees to be registered.

Nevertheless, such an agreement must be approved by a 'valid majority' of all the workers who are covered by it.

#### ► **Single Interest Employer Registered Collective Agreements**

Collective agreements are also available for employers who have franchisees involved and or integrated into their service. Protected action is also available in these types of agreements.

For instance, employers under the direction of a single entity like a franchisor can be covered by a single agreement.

#### ► **Low Paid Multi-Business Collective Agreements**

This is an agreement that covers one or more single businesses.

Employees who fall within the scope of the agreement are covered by it, they facilitate multi-employer bargaining including an order from the independent umpire that a

*relevant third party such as a contractor can be brought to the bargaining table and workplace determination in the event of a stalemate can occur where the parties consent.*

*Note, there is no legislative provision for protected action to be taken by employees in such instances.*

#### ► **Greenfields Collective Agreements**

*This is an agreement where it can be made where an employer is in the process of setting up a new business.*

*It may cover any category of employee provided that no employee has been engaged before the agreement is made. The advantage in doing such an agreement is that it will set the terms and conditions of employment which will cover employees who are subsequently hired. There are two types of greenfields agreements. First, a union agreement can be made with one or more unions who are entitled to represent the industrial interest of the workers likely to be covered by the agreement. Secondly, an employer greenfields agreement is essentially an agreement made by one part, that being the employer.*

*Following the enactment of the Fair Work Act new requirements regarding enterprise bargaining came into effect. Employers are required to issue a written notice to employees as soon as practical, but not later than 14 days after the employer initiates bargaining or agrees to bargain. This written notice is known as a 'Notice of Employee Representational Rights'. Amongst the mandatory content, this notice must contain information about the right of an employee to appoint a bargaining representative.*

## **EXTENT OF EMPLOYER OBLIGATIONS**

The extent of employer obligations under the Enterprise Bargaining requirements of the Fair Work Act are:

1. An employer is not obliged to bargain for an enterprise agreement in response to a union or other employee bargaining representative proposing an enterprise agreement.
2. An employer can refuse to bargain for an enterprise agreement or can make its agreement to bargain subject to a condition precedent as to the scope of any agreement. For instance, the employer can make it a condition that it will only bargain if the scope of the agreement is limited to a particular category or categories of employees.
3. If the union or other bargaining representative does not accept this condition, the employer is entitled to refrain from bargaining.
4. At this point, employees' bargaining representative may approach Fair Work Australia. The Fair Work Act allows for Fair Work Australia to order an employer to bargain with its employees subject to several conditions. Most importantly, Fair Work Australia must be satisfied that a majority of employees wish to bargain with the employer.
5. The employer is not required to make concessions during bargaining for the agreement nor is the employer required to reach agreement on particular terms that are to be included in the agreement.

## • Social Security

### EMPLOYER CONTRIBUTIONS

Employers must make superannuation contributions to the employees' to a designated superannuation fund at least every three months. The superannuation contributions are invested over the period of the employees' working life and the sum of compulsory and voluntary contributions, plus earnings, less taxes and fees is paid to the person when they choose to retire. The sum most people receive is predominantly made up of compulsory employer contributions. As at 1 July, 2017 the minimum rate of contribution is 9.5% of an employees ordinary salary.

Special rules apply in relation to employers providing defined benefit arrangements. There are less common traditional employer funds where benefits are determined by a formula usually based on final average salary and length of service. Essentially, instead of minimum contributions, employers need to provide a minimum level of benefit.

Superannuation Guarantee law applies to all working Australians, except those earning less than \$450 per month, or aged under 18 or over 70. Individuals can choose to make extra voluntary contributions to their superannuation and receive tax benefits for doing so.

## • Health and Safety

The various State health and safety laws are being harmonized on a national basis. Under the Work Health & Safety Act employers "officers" have a positive duty to ensure that the employer (company) is complying with its health and safety obligations. In addition, people that essentially act as shadow or de facto directors of the employer, will also be considered to be "officers. Accordingly, individuals within any businesses at a managerial level will be exposed to an increased risk becoming personally liable if they fail to exercise all due diligence in respect of the health and safety in their employers company or business.

The Work Health & Safety Act will also introduce significant changes to the management of safety in Australia, including:

1. Duty of Care - an expanded duty of care on all businesses and undertakings
2. Consultation - a broader requirement to consult and coordinate on safety with workers, contractors and others affected by the business or undertaking
3. Reputation – an approach to enforcement through greater use of adverse publicity orders
4. Intervention at the business – greater avenues for intervention by unions and the regulator at your business
5. Shift in attitude – by the regulators and courts in adopting a "uniform" approach to investigation and enforcement

A summary of the more significant areas of intervention are as follows:

► **Regulator Intervention**

<b>ACTIVITY</b>	<b>SECTION</b>
<b>Failure to negotiate work groups</b>	<b>54, 56</b>
Issues resolution	80-82
<b>Direction to cease unsafe work</b>	<b>89</b>
Review of Provisional Improvement Notice	100
<b>Dispute about WHS right of entry</b>	<b>141</b>
Creation of Health & Safety Committees	76
<b>Regulations</b>	<b>Coming soon</b>

► **Regulator Intervention**

<b>ACTIVITY</b>	<b>SECTION</b>
<b>Entry to inquire into suspected contraventions</b>	<b>117</b>
Entry to consult and advise workers	121
<b>Right of workers to be represented by union in negotiating work groups</b>	<b>52 (4)</b>
Right for a HSR to request the assistance of any person (including a union official)	68 (2) (g)
<b>Right of entry for resolution of Health and Safety issues</b>	<b>81 (3)</b>

• **Contracting and Outsourcing of Work or Services**

Contracting and outsourcing is a function of business operations in Australia. Outsourcing must be genuine. The courts look at the substance of the outsourcing contract not its form. If an agreement is really one of employment though clothed as an outsourcing contract, the courts will look through the form of the contract and impose the requirements of the employment laws.

## TYPES OF OWNERSHIP

Land may be held by individuals or companies. Provided notification is made, foreign individuals and companies can also purchase land in Australia.

Land acquired is held in fee simple. Subject to Government's having reserved the right to acquire land, land once purchased is the sole and absolute property of the purchaser.

Ownership of land by foreigners is permitted. See the section on Foreign Investment.

## LAND REGISTER

Generally ownership of land in Australia is recorded by the Torrens registration system. All land has a specific lot and plan number and the name of the owner is disclosed in the register. The register is authoritative as to who the owner of land is at a given time.

## TRANSFER FORMALITIES

Land is transferred by sale, gift or transfer upon death. For the transfer to be valid at law, it must be noted in the appropriate State or Territory Department of Lands registry.

A tax on the transfer of land from one person to another current applies in most States and Territories of Australia. The rate of Stamp Duty as this tax is called varies between the States and Territories. Anti-avoidance provisions exist to prevent people from seeking to avoid the payment of Stamp Duty using corporate and trust vehicles.

As at 1 July, 2011 there is no estate or death duties payable upon the transfer of land from a deceased to his or her beneficiaries.

## MORTGAGES

Mortgages are created and also recorded In the register pertaining to the land.

Mortgages can also arise without being registered although the level of security in such cases can be affected by the failure of the mortgagee to register the security interest in the land. In some cases, the mortgagee's security interest could be lost due to the failure to register the mortgage.

### **RESTRICTIONS ON ACQUISITION**

There are notification procedures to follow but in general there are no restrictions on foreign individuals or companies purchasing or holding land in Australia.

### **CONSTRUCTION AND USE RESTRICTIONS**

The permitted use of land is controlled by the third tier of government in Australia, the Local Council. When looking to purchase land, purchasers are advised to obtain the latest zoning certificate to ensure that the land can be used for the desired purpose of the purchaser.

Development cannot take place on land until the Local Council gives development consent to the proposal. The length of time it takes to obtain Development Consent following the lodging of a Development Application depends upon each State and Territory and each Local Council.

### **LEASES**

Land in Australia can be leased. The usual types of leases are leases for a term, leases at will and periodic leases.

Leases for a term greater than 3 years (inclusive of any option to renew) should be placed upon the register of the land.

No government permission is required for a land owner to grant a lease to a lessee.





# Kraft & Wildenhofer Rechtsanwälte

—  
Austria

📍 Kraft Rechtsanwalts  
GmbH & Co KG  
Heinrichsgasse 4  
1010 Wien, Österreich

☎ +43 1 587 16 60-0

📠 +43 1 586 31 17

✉ office@kwlaw.at

🌐 www.kwlaw.at

**Kraft & Wildenhofer's expertise is available in the following fields:**

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#### Commercial and Corporate

Formation of companies  
Acquisitions, mergers, takeovers  
Joint venture agreements  
Corporate restructuring  
Agency, distribution, franchising  
Unfair competition

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#### Real Estate

Acquisition, disposal of property  
Lease agreements

#### Professional Service, Personal Approach

The law firm was established in 1987 by Rainer Maria Kraft and is based in Vienna. The firm provides a comprehensive range of services to corporate and private clients with national or international interests. Unlike large law firms, Kraft & Wildenhofer's partners can ensure the sustained individual attention on which the successful solution to a case so often depends.

Through its expert contact in the world of business has access to the specialist knowledge and experience required to respond more effectively to today's increasingly complex world. These strengths are further reinforced by the firm's international network of law and accounting offices in the European Union, Central Europe and beyond – all of which share a belief in the importance and value of personal contact and responsibility in the practice of law.

In Austria, the firm keeps in close touch with accountants, tax advisers, notaries public, real estate brokers and managers, insurance agents and the banking and financial institutions, as well as the numerous experts required to give evidence in court. As a member of the Austrian Bar Association, the firm can represent clients before all the Austrian Courts, including the Courts of Appeal and the Supreme Court. Such strengths allow Kraft & Wildenhofer to respond to the most challenging tasks.

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#### Family and Estates

Wills  
Probate  
Trusts  
Estate planning

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#### Litigation

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#### Debt Collection

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#### IT Law / Data Protection

E-Commerce  
General Data Protect. Regulation

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#### Employment

Employment agreements  
Work and residency permits

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#### Capital Markets

Compliance issues  
Liability of investment counsels  
Licensing proceedings

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#### Intellectual Property

Trademarks  
Model and design

## REGULATIONS AND RULES

The main statutes in corporate law are the Code of Enterprises (Unternehmensgesetzbuch, UGB), which entered into force on January 1st, 2007, the Law on Limited Liability Companies (Gesetz über Gesellschaften mit beschränkter Haftung, GmbHG) and the Stock Corporation Act (Aktengesetz, AktG).

Other relevant statutes are the General Civil Code (Allgemeines Bürgerliches Gesetzbuch, ABGB), the Law on Co-operative Societies (Genossenschaftsgesetz), the Law on the Commercial Register (Firmenbuchgesetz), the Law on Private Foundations (Privatstiftungsgesetz), the Insurance Companies Supervision Act (Versicherungsaufsichtsgesetz) and the Act on the Statute of the Societas Europaea (SE-Gesetz).

## TYPE OF COMPANIES

The most common types of companies in Austria are the General Partnership (Offene Gesellschaft, OG), the Limited Partnership (Kommanditgesellschaft, KG), the Company with Limited Liability (Gesellschaft mit beschränkter Haftung, GmbH), the Stock Company (Aktiengesellschaft, AG) and the Private Foundation (Privatstiftung).

Since 2007 the most types of companies are also open to the so-called liberal professions („freie Berufe“), as for example lawyers, notaries, doctors, pharmacists, accountants or architects, however the various professional codes contain certain restrictions.

Further types of companies are the Civil Law Association (Gesellschaft nach bürgerlichem Recht, GesBR), the Cooperative (Genossenschaft), the European Economic Interest Grouping (Europäische wirtschaftliche Interessenvereinigung, EWIV), the European Company (Europäische Gesellschaft, SE) and the European Cooperative Society (Europäische Genossenschaft, SCE).

## LIABILITY OF SHAREHOLDERS

The liability of the shareholders of a Company with Limited Liability or a Stock Company is limited to their capital contribution. On the contrary the partners of a General Partnership are fully and personally liable for the debts of the Partnership, the liability to creditors cannot be limited. A Limited Partnership consists of at least one general partner (Komplementär), who is liable like a partner of a General Partnership, and of at least one limited partner (Kommanditist), whose liability is restricted to the amount of his capital contribution (Einlage).

## SHARE CAPITAL

The minimum share capital (Stammkapital) of a Company with Limited Liability is EUR 35,000. In principle, at least one half of the capital must be paid in cash (but there are exceptions for contributions in kind).

The minimum stock capital (Grundkapital) of a Stock Company is EUR 70,000. At least 25 per cent of the stated capital stock (plus any premium) must be paid up prior to the registration. The minimum nominal value of the shares is EUR 1,00 unless the shares simply represent a percentage of the share capital (without a nominal value). It is possible to issue non-voting preferred shares which grant a right to a preferred dividend but do not include any voting rights. Since 2011 non-listed companies have to issue registered shares.

There is no minimum share capital for General Partnerships and Limited Partnerships.

## CORPORATE GOVERNANCE

All partners of a General Partnership (and all general partners of a Limited Partnership) are entitled and obliged to manage and to represent the partnership. The partnership agreement may stipulate other regulations.

Companies with limited liability must have the following corporate bodies: (i) managing director(s) (Geschäftsführer), (ii) shareholders assembly (Generalversammlung). A supervisory board (Aufsichtsrat) is only compulsory for large companies (e.g., more than 300 employees) and optional for the others.

The shareholders assembly must meet at least once a year and is called by the managing directors. Shareholders resolutions can also be adopted by written consent, if all shareholders agree. The following decisions – inter alia – require a resolution by the shareholders:

- |  |  |
|--|--|
| 1. The appointment and dismissal of managing directors | 5. Changes to the articles of association, including an increase or reduction of the share capital |
| 2. Approval of the annual report                       | 6. Raising of claims against the managing directors  |
| 3. Distribution of profits                             | 7. Liquidation of the company  |
| 4. Release from liability of the managing directors    | 8. Mergers.  |

Generally, shareholder resolutions of a Company with Limited Liability require a simple majority of the shareholders present. Unanimous voting is required inter alia for a change of the object of business of the company. A majority of 75 per cent is required inter alia for changes to the articles of the association (with a few

exceptions) or the sale of the corporate assets as a whole. The articles of association may provide other rules.

The management board of a Company with Limited Liability consists of one or more managing directors, who are appointed and dismissed by the shareholders. The managing directors represent the company and do the day-to-day business. Usually the managing directors have an employment contract with the company which stipulates the remuneration of the directors. The managing directors are personally liable towards the company for exercising the care and diligence of a prudent businessman in performing their tasks. They are not personally liable towards creditors of the company in general but only if they violate special legal rules (e.g., the requirement that they file for bankruptcy on a timely basis).

The corporate bodies of a Stock company are the board of directors (Vorstand), the shareholders meeting (Hauptversammlung) and the supervisory board (Aufsichtsrat).

A shareholders meeting is called by the board of directors and must be held at least once a year within eight months after the end of an accounting year. The following matters, inter alia, require a shareholders resolution:

- |  |  |
|--|--|
| 1. Appointment of the members of the supervisory board   | 4. Approval of the annual report (unless the supervisory board approves it)      |
| 2. Appointment of the auditors   | 5. - distribution of profits   |
| 3. Changes to the articles of association, including an increase or reduction of the share capital | 6. - release from liability of the board of directors and the supervisory board. |

Shareholders resolutions are in principle adopted by a simple majority. For certain fundamental decisions, in particular changes of the articles of association a qualified majority of 75 percent of the votes is required.

The board of directors consists of one or more members, represents the company and carries out the day-to-day business. The members of the board of directors are appointed by the supervisory board for a period of 5 years (reappointment is permitted). Usually the members of the board of directors are employed with the company, and are regarded as free employees ("freie Dienstnehmer"), so they are not protected by labour laws. Profit shares are common. The members of the board of directors are personally liable towards the company for exercising the care and diligence of a prudent businessman in performing their tasks.

The supervisory board members are appointed by the shareholders meeting (except the representatives of the employees). There have to be at least three members.

The supervisory board must supervise the management board. A number of transactions must be approved by the supervisory board, e.g., the acquisition, alienation and mortgaging of real estate, opening and closing of branches, determination of the general business policy etc. The liability of the members of the supervisory board is the same as the liability of the members of the management board.

### **ANNUAL ACCOUNT - FINANCIAL AND OPERATING RESULTS**

The financial statements (Jahresabschluss) consist of the balance sheet, the profit and loss statement, an appendix and a position report.

The financial statements have to be prepared by the management within five months of the end to the accounting year. They require the approval of the shareholders assembly in the case of a Company with Limited Liability and the supervisory board in the case of a Stock Corporation. Furthermore a statutory audit is required for Stock Corporations, large or medium sized Companies with Limited Liability, banks, insurance companies and investment funds.

The financial statements must be filed with the commercial register (except Partnerships which must only register if the general partner is a corporation) within nine month of the end to the accounting year. Large Stock Corporations, companies listed on the stock exchange, banks, insurance companies and investments funds must publish the financial statements in the “Wiener Zeitung”. Any delay in such filing of the financial statements is subject to a penalty which is imposed against the company and the managing director (Sec 283 UGB).

### **ESTABLISHING OF A COMPANY**

For the foundation of a Company with Limited Liability the registration with the Commercial Register is necessary. The following documents have to be filed: (i) articles of association including at least the name and the legal seat of the company, the company purpose, the amount of the share capital and the contribution of every shareholder. The founders have to appoint managing directors, who have to sign specimen signatures, which are deposited at the Commercial Register. The Application for Registration has to include an affidavit to be issued by the managing director that the share capital has been paid to the bank account of the company and that the managing director may dispose of it without third party rights.

### **LIQUIDATING A COMPANY**

For Corporations such as the Company with Limited Liability and the Stock Corporation a formal winding-up procedure is provided by law. If the shareholders agree to dissolve the company or the company is dissolved of any other reason,

the company enters into a liquidation period. During this period the company is represented by the liquidators (who may be the directors or third parties). The property of the company is sold and the debts are paid. The remaining funds are distributed to the shareholders. At the end of the procedure the company is struck from the register.

## **REFORMS AFFECTING COMPANIES WITH LIMITED LIABILITY (SMALL ENTERPRISES)**

In 2013 a reform was issued allowing the foundation of a company with limited liability with a minimum capital of EUR 10,000, which has to be paid in half. This privilege of foundation (“Gründungsprivileg”) has to be mentioned in the company register. With a change of the articles of association and payment of the missing “normal” minimum capital of EUR 35,000 this privilege ends. In any case the privilege ends after 10 years after the foundation, which means that the capital has to be increased to EUR 35,000. The main advantage of this reform is a reduction of foundations costs.

As of January 1st, 2018 it will be possible to establish the so called “single member” or “one-person Company with Limited Liability”. The purpose of this new concept is to simplify and thereby to speed up the process of the foundation of a company with limited liability and therefor to minimize the expenses. The creation of the simplified company with limited liability is possible when the one and only shareholder is an individual person and managing director at the same time. To establish the company a notarial deed is not needed. The electronical way of foundation is enough, though it is required to doubtlessly determine the identity of the only shareholder. The application for registration in the companies register is carried out electronically by the bank after the capital is paid in cash and the identity of the shareholder is successfully determined.

## • Corporate Taxes

### TAXES ON CORPORATE INCOME

The profits of a corporation are taxed at the company level at a flat rate, while profits of individuals (and partnerships) are taxed at a progressive rate (exceptions see below).

Since 2005 the rate of the corporate income tax is 25 per cent (previously being 34 per cent). Therefore, the level of corporate income tax in Austria is now comparatively low.

The profits of a corporation are taxed whether the profits are paid out to the individual shareholders or retained in the company. Dividends paid to individual shareholders are subject to a withholding tax of 27.5% since January 1st, 2016. (Therefore, profits of a corporation which are paid to their shareholders are taxed in all with a rate of 45.63 per cent). Corporations have to pay a minimum tax related to the minimum capital. For Stock Corporation this amounts to EUR 3,500. For existing companies with limited liability the tax amounts to EUR 1,750. For companies with limited liability founded after June 30th, 2013 the minimum tax for the first five years is EUR 500 per year, during the next five years EUR 1,000. As of the 11th year the full tax has to be paid. The minimum corporate income tax has to be paid even if no profit is generated.

The taxation of private foundations differs from the taxation of other legal entities: the dedication of assets to a foundation is, generally, taxed with 2.5 % (the tax rate is 25%, e.g., if the documentation is not disclosed or the foundation is not comparable to an Austrian one). Some types of incomes, e.g., income from bank deposits, debt securities or from the sale of participations are subject to a tax rate of 25 % (interim tax) as long as they are retained (this tax is credited when the amount is paid to the beneficiary). Dividends from participations in an Austrian corporation and – under certain circumstances – from a participation in a comparable foreign corporation are tax exempt. Benefits to the beneficiary from the substance are tax-free, whereas such from the proceeds are subject to the capital gains tax of 27.5%.

### CORPORATE RESIDENCE

A company is resident in Austria if it has its legal seat (as designated in its statutes) or its place of effective management in Austria. A company with its residence in Austria is taxed on its worldwide income. A company with no residence in Austria

is taxed on its income earned through the activities of a permanent establishment in Austria and its incomes from immovable property located in Austria, capital gains on the sale for shares in resident companies (if the shareholding has amounted at least 1 % at any time during the last 5 years) and royalties (see below).

## OTHER TAXES

Other relevant taxes are:

Value added tax: The rate is in general 20 %; 10 % are charged for leases of land and buildings for residential purposes, transport of passengers (except airfares), foodstuff, books; 13 % are services rendered by film-theatres, artists, sale of livestock, plants, camping and hotel accommodation.

### 1. Real estate transfer tax

Rate 3,5 % (until December 31st, 2015 the tax rate was 2 %, if the real estate is transferred between close relatives and/or spouses, as of January 1st, 2016 the tax rate is staggered).

### 2. Capital transfer tax

None (until December 31st, 2015 the rate was 1 % in particular for issuing shares in a domestic corporation (company with limited liability and stock company).

### 3. Stamp duties

E.g. for lease agreements, suretyships, assignments etc.

There is no property tax in Austria, only the possession of real estate is taxed with an annual rate of app. 1 % of the assessed value (Einheitswert), which is regularly beneath the actual value.

Since 2008 no inheritance and gift tax is imposed any longer due to a ruling of the Austrian Constitutional Court.

## BRANCH INCOME

A company with its residence in Austria is taxed with its worldwide income (including the incomes of a foreign branch). A company with no residence in Austria is taxed on its income earned by a branch in Austria. Austria is party to a number of tax treaties which seek to avoid double taxation.

## INCOME DETERMINATION

Inventory generally has to be valued at the lower of cost and market value. If inventory is valued according to cost, the FIFO method is generally accepted. The LIFO method is allowed only if it is in accordance with the company's actual practice.

Capital gains from the sale of business assets are generally included in taxable income and are taxed at the standard rate.



## PARTICIPATIONS

Capital gains (dividends) from a shareholding in domestic subsidiaries and foreign companies (under certain circumstances, e.g., EC companies or other foreign companies comparable to Austrian companies from countries providing Austria with full administrative assistance) are exempt from taxation. This exemption applies irrespective of the amount of holding and the holding period. Withholding tax is levied for dividends from domestic participations not exceeding a 10% participation. Gains from the sale of participations or from liquidation of the company are taken into account.

Dividends from international participations (parent company is subject to unlimited income taxation in Austria, subsidiary is comparable to an Austrian company, the participation exceeds 10% of the subsidiary's capital and is held for more than one year) are tax-free. This also applies to gains from the disposal or liquidation of such participations unless the parent company irrevocably opts into taxability (including the possibility for depreciation to the shares' fractional value).

The above mentioned exemption does not apply if the foreign company is either not subject to a comparable company tax abroad or tax-exempt due to special foreign provisions or the foreign tax rate is below 15%. In such cases Austrian Law changes the system: instead of the exemption method the credit method is applicable. Furthermore no exemption applies if foreign capital gains are deductible abroad.

## DEDUCTIONS

Generally, all expenses being caused by running a business are deductible. The costs for business lunches are deductible with 50% if made for promotion purposes. Since March 2014 costs for personnel exceeding EUR 500,000 per year and person are not deductible anymore. Compensation payments for supervisory board members are only deductible with 50%.

The basis for depreciation is the cost price or production cost. Only the straight line method of depreciation is permitted by tax laws (no progressive or diminishing balance depreciation is allowed). The depreciation period is from 5 to 10 year for machines, at least 8 years for passenger cars, 15 years for the goodwill, 33 1/3 years to 66 2/3 years for buildings depending on the use of the building. Excess write down to the lower going concern value (= fraction of the total purchase price that a buyer of the whole company would pay for a certain asset assuming the buyer intends to continue the business) is only possible in case of technical or economic obsolescence. Some assets cannot be depreciated, in particular real estate.

Net profit losses may be carried forward without any time limit. The former provisions that only loss carry forwards can only be set off against 75% of the income

applies only to companies after the year 2014. To avoid misuse of losses carried forward a change in ownership of the company shares under certain circumstances, namely a substantial change of the shareholders (more than 75 per cent), a substantial change in the organization and a substantial change in the economic structure without reorganization reasons (so called “Mantelkauf”), lead to a loss of the ability to carry forward the net profit losses of the previous years.

Although there are no statutory provisions specifically dealing with transfer pricing the arm’s length principle is applied in Austria because of general rules of the Austrian tax law. The income tax and the corporate income tax are not deductible.

### GROUP TAXATION

Since 2005 Austrian tax law allows the building of a tax group. The group parent needs an equity participation of more than 50 per cent (directly or indirectly) including the majority in voting rights. It is also possible to build a group where one company holds at least 40% and another at least 15% (Mehrmüttergruppe). Such participation has to last for at least three years and an application with the tax office has to be filed. Irrespective of the participation held, 100 % of the profits and losses of Austrian group members will be attributed to the group parent, as of January 1st, 2015 75 % of losses of foreign group members will be attributed. Undistributed profits of foreign group members are not attributed to the parent company, distributed profits are tax-free (international participation). Foreign group members resident in countries without administrative assistance cannot become members anymore, with 2015 such existing foreign group members are excluded from the group by law.

### TAX INCENTIVES

There are several tax incentives in Austria, e.g., different forms of research tax allowances, an education allowance and an education premium, or an apprentice premium.

An invention allowance for example is granted for expenses incurred in the development or improvement of inventions valuable for the economy. An education allowance is granted for expenses incurred for the education and training of employees. It amounts to 20 % of these expenses.

Since 2010 individuals can participate from the new profit tax allowance (Gewinnfreibetrag): a differentiated rate of the profits can be deducted as notional operating expenses, in total up to EUR 45,350. A part of EUR 3,900 can be set off without any further requirements; the other parts depend on the actual investment in securities and certain assets.

## WITHHOLDING TAXES

A withholding tax of 27.5 % (since January 1st, 2016) is levied on dividends distributed by a resident company to its Austrian shareholders. For natural persons, generally, the taxation is final (Endbesteuerung). No withholding tax is levied if the parent company holds more than 25% of the capital, for lower participations the withholding tax is credited. Dividends of resident companies to its foreign shareholders in the EC/EEA are tax-free if the participation exceeds 10% and exists for more than one year.

Double taxation treaties can contain lower tax rates./ Interest income from other sources is subject to standard corporate income tax (or individual income tax)./ Royalties paid to non-residents are subject to a final withholding tax of 20 % unless a reduced rate applies under a tax treaty.

Tax rate on dividends, interest and royalties according to tax treaties:

### Selected Countries

Country	Dividends	Interests	Royalties
Australia	15	10	10
Belgium	15	15	10 (0 in some cases)
Brazil	15	15	Up to 25
Canada	15	15	10
Denmark	0 or 15	0	0
France	0 or 15	0	0
Germany	5 or 15	0	0
Italy	15	10	10 (0 in some cases)
Japan	10 or 20	10	10
Korea	10 or 15	10	10
The Netherlands	0 or 15	0	10 (0 in some cases)
Portugal	15	10	5 or 10
Russia	5 or 15	0	0
Spain	10 or 15	5	5
Switzerland	0 or 5	5	5 (0 in some cases)
United Kingdom	0 or 15	0	0 (10 in some cases)
USA	5 or 15	0	0 (on films 10)

## TAX ADMINISTRATION

A company must file the annually corporate income tax return by April 30 (by June 30 when filed electronically) of the subsequent calendar year (no matter when the financial year ends). If the company is represented by a tax advisor the period for filing the return may be extended.

Prepayments of Corporate Income tax must be made in four equal payments by February 15, May 15, August 15 and November 15 in accordance with the assessment notice issued by the tax authorities (based on the previous year's tax pay-

ments). If the Corporate Income Tax is more than the prepayments the difference must be paid within a month after receiving the tax statement. Excess prepayments are refunded.

## • Individual Taxes

Different from the Corporate Income Tax the individual Income Tax is not a flat tax. The tax rate here is progressive (7 rates, maximum rate is 55 %).

Partnerships as such are not a subject of taxation, but the partners are. The profits of the partnership are first calculated for the partnership as a whole and then shared amongst the partners. The partners have to pay income tax (or Corporate income tax if the partner is a corporation) to their portion of the profit.

### TERRITORIALITY AND RESIDENCE

Individuals who are residents of Austria are liable to Austrian Income Tax on the worldwide income. A person is regarded as resident if he has a domicile (= place where he occupies a residence under circumstances, which indicates that he will retain and use it on a basis which is not merely temporarily) or his customary place of abode (= physical presence over an extended period) is in Austria. A person who remains in Austria for 183 or more days during a year in Austria is considered to have his customary place of abode.

A person with no residence in Austria is only subject to Austrian income tax for specific income sources or assets.

### GROSS INCOME

There are seven sources of income:

- Agriculture and forestry
- Trade or business
- Independent personal service (e.g. lawyers, tax advisors)
- Employment
- Investment of capital
- Rental and royalties
- Other income sources

The income from the first three sources (so called business income) is calculated in a manner similar to the treatment of income of a corporation (see above).

The taxable income from the four other sources is determined by deducting from the gross income any expenses that are incurred to acquire, safeguard and maintain this income (so called Werbungskosten).

From the employee's gross salary social security contributions, kilometre and daily allowance (up to a certain limit) or distributions of the employer to a pension funds in favour of the employee are deducted. Non-recurring payment of salaries, in particular 13th and 14th salary (vacation and Christmas remuneration) enjoy a tax-free allowance of EUR 620 per year and excess amounts are also tax-advantaged depending on the amounts been paid.

In 2012 the tax treatment of capital gains from the sale transfer of non-business property has been changed: profits from the sale of real estate (difference between proceeds and acquisition costs) after April 1, 2012 are taxed with a special rate of 25%. After January 1st, 2016 the tax rate has increased to 30%. An option to the normal taxation with the standard rates is possible.

Exemptions apply if the real estate has been the main place of residence for at least 2 years since the acquisition or for at least 5 years within the last 10 years or if the building has been newly built and not used as an income source in the last 10 years.

Gains on the sale of other goods despite capital assets and real estate within one year are tax-free if below EUR 440. Losses cannot be deducted.

After January 1st, 2016 gains on the sale of participations will be taxed on the new withholding tax regime (27.5 % withholding tax) regardless of the amount of holding and the holding period.

## DEDUCTIONS

As mentioned above expenses that are incurred to acquire, safeguard and maintain this income are deductible

### 1. Furthermore taxable income is reduced by:

Special personal expenses (Sonderausgaben), e.g., premiums paid into voluntary health, accident and life insurance programs, payments incurred to finance private house building and improvement (contracted before January 1st, 2016), purchase of newly issued shares or profit sharing certificates. The maximum amount being deductible, generally, is EUR 2,920; only 25 % of the payments made are deductible with limitation; contributions to churches, contributions to charitable organisations, tax losses carried forward from previous years etc. are deductible, too.

- 2. Extraordinary expenses (außergewöhnliche Belastungen):**  
Payments incurred by a taxpayer because of extraordinary circumstances (e.g. natural catastrophes, children's tuition away from home, etc.).
- 3. Several deductible amounts stipulated by law (Absetzbeträge) e.g.:**  
Sole earners: EUR 494, -- (with one child) + additional amount depending on the number of children); Sole earners with children and no spouse or partner: EUR 494, -- + additional amount depending on the number of children)
- 4. Employees:** EUR 54,--.

## TAX CREDITS

Some of the deductible amounts stipulated by law reduce the income tax even if they exceed the tax. Therefore, a negative in-come tax is possible and the taxpayer is granted a tax credit which is paid to him.

## OTHER TAXES

Social security distributions are mandatory, but these are not regarded as taxes in Austria. There are no local taxes on income, but the employer has to pay a local tax (Kommunalsteuer) on basis of the sum of wages he pays to his employees (tax rate is 3%).

# Austria | FOREIGN INVESTMENT

## REGISTRATION WITH GOVERNMENT, AUTHORITIES AND PERMITS

There are in general no restrictions on converting or transferring funds related to foreign investments. All cross-border capital transactions for non-residents and residents, including the acquisition of Austrian securities, debt services, the repatriation of profits, interest payments, dividends and proceeds from the sale of investment are unrestricted.

Nevertheless the Austrian Central Bank (Nationalbank) is entitled to enact restrictions pursuant to EU-law under certain circumstances, e.g., major difficulties in international relationships, where the security of Austria is endangered, etc. In this case certain transactions require the permission of the Austrian Central Bank.

The EU-directives on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing do apply.

Furthermore various transactions related to foreign countries, e.g. foreign direct investments, must be notified to the Austrian Central Bank for statistical purposes.

Austrian Foreign Trade Law and the applicable EU directives provide for restrictions regarding the import and export of certain goods (e.g. fire arms).

The nine provinces have established regulations (Grundverkehrsgesetze) under which the acquisition of real estate (and certain rights related to real estate) by foreigners (in some cases also by Austrians) is subject to approval by the provincial authorities. These restrictions concern primarily real estate for agriculture use and real estate in tourist regions. The regulations differ from province to province.

Most business activities in Austria require a business license (Gewerbeberechtigung). If the business is conducted by a corporation, a partnership or a branch of a foreign company an individual person (trade manager) must be named who is responsible for the correct conduct of the business. This person is commonly called the “gewerberechtlicher Geschäftsführer”, who must be resident in Austria, in the EEA or Switzerland or in a country where penalties of Austrian administrative authorities can be executed. Since the manager must be in a position to work in the business accordingly which the authority checks, therefore, in most cases a “gewerberechtlicher Geschäftsführer” is nominated who is resident in Austria.

## TRANSFER OF DIVIDENDS, INTERESTS AND ROYALTIES ABROAD

Austria does, generally, not restrict the transfer of dividends, interests and royalties abroad. The exemptions are mentioned above.

For the taxation of these transfers see section “Tax Law”.

## FOREIGN PERSONNEL

There are restrictions on employment of foreign employees.

Citizens of the „old“ EU member states plus citizens of the member state of the enlargement 2004 have already been entitled to work in Austria without a work permit. On December 31st, 2013 the restrictions concerning citizens of Bulgaria and Romania ended. Currently special transition rules still apply for citizens of Croatia.

The former system of a quota-based system has been changed. For key personnel, high qualified persons and skilled workers in shortage occupations the “Red-White-Red-Card” is possible: the work permit is valid for a certain job in a certain company for a maximum period of one year. After a year a (i) “Red-White-Red-plus” card or (ii) a temporary residence permit is possible. The “Red-White-Red-plus” allows working not only in a certain job but in the whole country. After five years a residence permit EC (Daueraufenthalt EU) can be obtained if an integration agreement (especially evidence of knowledge of the German language has to be provided) is fulfilled.

Additionally, there are special provisions regarding juvenile persons, family reunification and citizens of non-EC member states having a residence permit of another EC-member state.

Foreign companies who perform services in Austria with foreign personnel have to consider that some rules of Austrian labour law apply, e.g., the minimum salaries stipulated in collective bargaining agreements, restrictions of working time etc. Any violation of provisions can lead to administrative penalties.



# Austria | LABOUR LAW

Austrian labour law is characterized by high standards of protection of the employees' rights and the importance of collective bargaining (company agreements are less important). Therefore, the possibility to govern the labour conditions by individual contracting is restricted.

## EMPLOYMENT CONTRACTS

The most important distinction is drawn between white-collar workers (Angestellte) and blue-collar workers (Arbeiter). White-collar workers are employed in commercial, higher non-commercial or clerk services, all other employees are blue-collar workers. Since this distinction is commonly seen as antiquated, in recent years the legal rules for white-collar workers and blue-collar workers have been adjusted, but there are still some differences, e.g. the periods of termination still differ. Furthermore, in many sectors there are different collective bargaining agreements for white-collar workers and blue-collar workers.

In addition to the usual labour contract, there is the possibility to enter into a free labour contract (freier Dienstvertrag). In a free labour contract the "employee" is not personally dependent on the "employer" (e.g., he can set his working time by himself, he works with his own equipment etc.). Only a few labour laws apply to free labour contracts.

A labour contract may be concluded for a definite or indefinite period of time. A contract for indefinite time can always be terminated by an ordinary termination (Kündigung) by both of the parties, provided they comply with certain notice requirements (termination periods and dates). The termination period the employer must comply with depends on the years of service: in case of white-collar workers, it may run from 6 weeks (in the first two years of service) to 5 months (after 25 years of service). A white-collar worker must comply with a termination period of one month. The statutory termination period may be lengthened but not shortened by the individual contract. The period the employee has to comply with must not be longer as the period the employer has to comply with. The employer of a white collar worker may terminate the contract to the end of each quarter; the white-collar employee may terminate employment to the end of each month. This rule can be changed by contract, so that both parties may terminate the contract on 15th or the last day of the month. In the case of blue-collar workers, the applicable termination period is two weeks for both parties, there are no certain termination dates. The period may be lengthened or shortened by collective bargaining or by contract. In enterprises where a work council is actually established the work council must be informed by the employer before giving notice of the termination to the employee.

An ordinary termination may be challenged by the employee if he works in a plant/factory where establishment of a work council is required (see below). A termination can be challenged because of a proscribed reason of the termination (e.g., union activity, activities in organizing the election of a work council) or because it was socially unjustified (important for elder employees). For some protected groups as members of the work council, pregnant employees, handicapped people or apprentices terminations are restricted.

Beside ordinary termination contracts (whether for a definite or indefinite period of time) may be terminated with immediate effect if there are important reasons that make the continuation of the employment unacceptable for one of the parties. The employer may immediately terminate the labour contract if the employee is disloyal in his service, incapable of performing his services, refuses to comply with orders of the employer etc. If the dismissal is not justifiable because there is no important reason the employment nevertheless ends immediately, but the employee will be entitled to full pay as if the employer would have ordinarily terminated the employment.

If an employment contract or a freelance contract is terminated after 31.12.2012, generally (e.g., in case the contract is terminated by the employer, in case of unjustified dismissal or contracts ending by passage of time), a fee of EUR 124 in 2017 (Auflösungsabgabe) has to be paid by the employer. Under certain circumstances no such fee applies: termination by employee, justified dismissal, etc. An employee, whose employment has lasted for at least three years, is entitled to severance payment (Abfertigung) in the event of ordinary termination by the employer, termination by mutual consent, justified immediate resignation by the employee, unjustified dismissal by the employer, time lapse and resignation due to pregnancy. The severance payment depends upon the time of service and ranges from 2 months' salary to 12 months' salary. The Act on Statutory Corporate Employment Retirement Scheme (Betriebliches Mitarbeiterversorgungsgesetz) applies to contracts beginning after December 31, 2002 (there is an opt-in-possibility for older contracts). Under this new legislation the employer has to pay 1.53 % of the monthly remuneration to a fund which pays the severance payment.

The members of the managing board of a Stock Corporation are excluded from the protective provisions of the labour law. However, labour law may apply to managing directors of a Company with Limited Liability depending on the rights and duties they have. Shareholders holding a majority or a blocking minority of shares will not be regarded as employees if they serve as managing directors of that company.

## EMPLOYEES REPRESENTATIVES AND UNION REPRESENTATION

In Austria there is only one trade union, the Austrian Trade Union Federation (Österreichischer Gewerkschaftsbund, ÖGB). The influence of the trade union is still significant since the Austrian Trade Union Federation conclude collective bargaining agreements (see below).

Members of the staff of companies having at least five employees are entitled to establish a work council (Betriebsrat). The number of members depends on the number of employees. The members of the work council need not to be members of the trade union. The work councils, therefore, are formally independent from the trade union although in fact there are often connections. A work council may conclude company agreements with the owner of the company (see below).

The members of the work council enjoy certain privileges and the law provides them specific protection (e.g., protection against termination). If their duties as members of the work council requires them to perform such activities during normal working hours their salary must not be reduced. In companies with a great number of employees (more than 150) one or more members (2 if there are more than 700 employees, 3 if there are more than 3000 employees) of the work council are entitled to be totally released from their duty under their employment contract. Members of the work council must not be discriminated against.

There are no specific privileges for members of the Trade Union but a termination because of union activities is not justified (see above).

## COLLECTIVE BARGAINING AGREEMENTS, COMPANY AGREEMENTS

The parties of collective bargaining agreements are the Austrian Trade Union Federation and statutory employer organisations, in particular the chamber of commerce (Wirtschaftskammer) and its sub-organizations. Generally collective bargaining agreements are concluded for a specific sector or branch, in most of the cases they apply to the whole territory of Austria, but there are also collective bargaining agreements applicable only in a certain province. The collective bargaining agreements apply to all employees in the specific branch, no matter if they are members of the trade union or not. Collective bargaining agreements govern the main aspects of the employment like wages, working conditions, working time etc. They apply to all employment relations, overriding the individual contract, except where the terms of the individual contract are more favourable to the employee. Collective bargaining agreements are thus of great significance in Austria.

Company Agreements are concluded between the management of the company and the work council (if there is no work council, no company agreement can be concluded). Only specified matters can be governed by a company agreement, e.g., establishing of piece-work system, regulation of the daily work time etc. Company Agreements are less important than collective bargaining agreements.

## EMPLOYMENT REGULATIONS

Austrian labour law is split up to many different statutes. For white-collar workers the Act on white-collar workers (Angestelltengesetz) is of great importance. Other important acts are the Labour Relations Act (Arbeitsverfassungsgesetz), the Vacation Act (Urlaubsgesetz) and the Working Time Act (Arbeitszeitgesetz).

## SOCIAL SECURITY COSTS

The employer must notify the beginning and the end of an employment to the social insurance agency. The employer is liable for the payment of the social security costs. The contributions must be paid monthly by the last day of the month. The social security contributions consist of an employee's contribution which is deducted from the salary and an employer's contribution which must be paid in addition to the salary. The employer is liable for the payment of the employer's contribution and the employee's contribution.

The employees contribution is currently (2017) 18.12 per cent of the salary for white collar-workers and 18.12 per cent of the salary for blue-collar workers

The employers contribution is currently (2017) 21.48 per cent of the salary for white collar workers and 21.48 per cent of the salary for blue collar workers.

There is a ceiling on the basis for contribution (Höchstbeitragsgrundlage) of EUR 4,980 a month (in the year 2017) which means no social insurance contributions have to be paid for the part of the salary exceeding this ceiling.

Generally, all parts of the remuneration (including remuneration in kind and overtime payments) are the basis for the social insurance contribution, but there are a few exceptions, e.g. work clothes, meals at a reduced price, contributions to a pension's fund.

## HEALTH AND SAFETY

Austrian labour law includes detailed provisions on occupational safety and health which the employer has to comply with. The employer has the duty to take measures to protect the life, the health and the morality of his employees at their work place. These regulations cover the size, lightning and ventilation of rooms, fire prevention, first aid, compulsory safety instructions etc. Compliance with these provisions is monitored by the Work Inspection Authority (Arbeitsinspektorat). Depending on the numbers of employees one or more person responsible for safety (Sicherheitsvertrauensperson) has to be appointed.

Important statutes in this field are the Act on Safety and Protection of Health at work (ArbeitnehmerInnenschutzgesetz) and the Act on Work Inspection (Arbeitsinspektionsgesetz).

### **CONTRACTING AND OUTSOURCING OF WORK OR SERVICES**

If work is outsourced this may be deemed as transfer of business (Betriebsübergang) and the corresponding regulations apply (liability of the old owner, position of the employee must not deteriorate). According to the Austrian provisions any transfer of business, generally, has no consequence for the employees being affected – any purchaser enters into their unchanged contracts. An important exception exists for the transfer of a business by share deal: since the employer (being the company itself) is still the same, no transfer of business is made and the above mentioned protection provisions are not applicable.

If freelancers are engaged it is important to formulate a contract which is not deemed as illegal avoidance of labour law. Therefore the freelancer must not be personally dependent on the employer (see above). If the contract is deemed as illegal avoidance of labour law, labour law nevertheless applies.

The following statutes regulate real estate in Austria:

- General Civil Code (Allgemeines Bürgerliches Gesetzbuch - ABGB)
- General Land Register Act (Allgemeines Grundbuchsgesetz)
- Real Estate Transaction Laws (Grundverkehrsgesetze) of the nine provinces of Austria
- Rent Control Act (Mietrechtsgesetz).

## TYPES OF OWNERSHIP

- **Ownership – Co-ownership – Condominium:** Ownership in the sense of Austrian law is generally defined in § 354 ABGB. Consequently ownership on a piece of real estate means, as in all states of Central Europe, the right on the one hand to make use of the substance and the pro-ceeds from a property, principally without any restriction, and on the other hand to exclude other people therefrom.  
It is also possible, that more than one person is owner. In the case of joint ownership (Miteigentum) each owner has the right to participate proportionately on the earnings of the property and to request dissolution of the co-ownership. This is however not allowed, if the dissolution would be detrimental to at least one other co-owner.  
Condominium is a special form of the co-ownership and means, that each co-owner has the exclusive right to use a certain apartment in a building, existing on the purported property.
- **“Usus fructus”:** means the right to use a certain piece of real estate whose owner is someone else and consume all earnings of this property.
- **Construction Right (Baurecht):** A construction right principally means the right to construct a building on the surface of a property owned by another one. This right is transferable and has to be constituted by a contract with the owner of the real estate. Furthermore it is limited for certain time.  
Closely related with the Construction Right is the “Superaedifikat”.

## LAND REGISTER

In Austria rights according to real estate, especially the ownership, “usus fructus”, mortgages (Hypotheken), easements (Dienstbarkeiten) and Construction Rights (Baurecht) are recorded in the Land Register, administrated by the District Courts (Bezirksgerichte). Currently there exist 116 District Courts.

The Land Register is divided into in the main register (Hauptbuch) and the document collection (Urkundensammlung). Each piece of real estate has a lot number (Einlagezahl). This register maintains three schedules of each lot number:

- Schedule A is the schedule of estate (Gutbestandsblatt)
- Schedule B is the schedule of the ownership (Eigentumsblatt)
- Schedule C is the Schedule of encumbrances (Lastenblatt). This schedule especially shows mortgages and ease-ments.

The Austrian land register is a public data bank, so everyone is entitled to inspect all documents. Furthermore the Land Register is subject to the principle of priority, which means that a right registered first prevails over all rights which have been registered subsequently, and the principle of confidence, which means, that everyone can rely on the assumption that the registered information concerning the ownership and especially the schedule of encumbrances is right and complete.

### **TRANSFER FORMALITIES**

It is not necessary that a contract to establish rights and encumbrances on real estates is constituted in the form of a notary deed. Only the declaration of the registered owner that he agrees to the registration of the right which is subject matter of the concerning contract in the Land Register (Aufsandungserklärung) needs a certification by a notary public.

### **MORTGAGES**

A mortgage is the right of a creditor to obtain satisfaction of a debt from a certain piece of real estate if the obligation is not fulfilled as agreed. The mortgage depends on the existence of the secured debt and comes into existence with its registration in Land Register schedule C.

A registration is only allowed in case that the document, which is the basis for the mortgage, contains a certain sum of money or a reference to a maximum amount of money (Höchstbetragshypothek) and is duly signed by the registered owner and certified by a notary. Furthermore it is possible that more than one mortgage is registered on one piece of real estate. In this case the ranking between the mortgages depends on the day of registration in the Land Register (principle of priority).

Where the secured debt is not repaid as agreed, the creditor has the right to initiate a public sale of the property by order.

### **RESTRICTIONS ON ACQUISITION**

All nine provinces of Austria have enacted Real Estate Transaction Laws (Grundverkehrsgesetze) which contain various restrictions. Since Austria became member of the EU many restrictive provisions in these laws have been liberalized, so that all EU-citizens are equally treated.

The existing restrictions are to be split up in two parts: On the one hand there are constraints for real estates used for agricultural purpose and on the other hand there are restrictions on properties in certain areas which are of special interest for tourism.

In both cases the acquisition of real estate and other certain rights is subject to approval by the Land Transfer Authorities (Grundverkehrsbehörden).

### SPECIAL LEGAL PROTECTIONS FOR PARTIES

In case a consumer concludes an agreement to become owner or tenant of a property, he has the special right to withdraw from this contract within one week, if the contract was signed on the day of the first examination of the subject matter of the contract. The possibility to withdraw from this contract is not accessible when the subject matter of the contract is a vacation flat or business premises.

### CONSTRUCTION AND USE RESTRICTIONS

A number of restrictions concerning the use of real estate law can be found in public law. Not all of them can be mentioned here. The most important are:

- If it is planned to build a house or another building on a certain property, it is necessary to obtain a building license (Baubewilligung)
- It is not possible to obtain a building permit on every piece of real estate. It is important to know that there is a land development plan (Flächenwidmungsplan) for every piece of Austria. This plan divides the concerning area in different zones. For example agricultural or building land. It is forbidden to construct buildings on agricultural land.

### LEASEHOLD TYPES

The Austrian civil law differentiates between two kinds of leases. One is named “Miete” and the other “Pacht”. The difference is very important, as legal consequences differ. In a “Miete” the lessee (Mieter) has the right to use the object of lease. In case of “Pacht” the lessee (Pächter) has not only the right to use but also to participate in the earnings of the concerning property.

In case of “Miete” the lessee is highly protected by the provisions of the Rent Control Act (Mietrechtsgesetz, MRG). Especially restricted is the right of the lessor (Vermieter) to terminate the lease contract of land and to determine the amount of rent.

Of certain interest are the following limitations of the lessor:

- **Temporal limitations**  
It is only possible to place a contract of lease under temporal limitation, if this agreement was settled in written form. Moreover not every temporal limitation is possible, as the Rent Control Act appoints minimum respites.



- **Reasons for the lessor to terminate the contract**  
Generally the lessor is only allowed to terminate the contract for important reasons. The Rent Control Act enumerates several important reasons. It is for example possible to terminate the contract, if the lessee does not use the property for the purpose under the contract or does not pay the rent punctually.
- **Upper limit for the rent**  
Generally the lessee and the lessor can stipulate an adequate rent. For certain kinds of apartments, especially if they are of a lower category, the Rent Control Act provides low upper limits for the rent.

The whole provisions of the Rent Control Act (Mietrechtsgesetz) are mandatory (ius cogens) and cannot be (with some exceptions) changed by contract to the disadvantage of the lessee. Where a contract includes some less favourable passages, the lessee is not bound by these contractual obligations and can rely on the provisions of law.

§ 1 MRG regulates the appliance of the Rent Control Act. Not all leases are subject to the Rent Control Act. In particular, leases which fall under the category of “Pacht” are not regulated by Rent Control Act. In this case the lessee consequently cannot rely on the protections of the Rent Control Act.

#### **LEASE FORMALITIES**

Generally there are no formalities for lease contracts in the Austrian law, albeit there are several exceptions to this tenet. Most of these exceptions are provided in the above mentioned Rent Control Act.



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Brazil

L.O. Baptista Advogados Associados

Bulgaria

Bazlyankov, Stanoev & Tashev Law Offices

# L.O. Baptista Advogados Associados

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Brazil

## Contact Person

Sueli de Freitas Veríssimo Vieira  
*Partner*

## References

Available upon request.

## Areas of Practice

Corporate, M&A, Foreign Investment, Litigation, Environment, Tax, International & Local Contracts and Arbitration, Labor, Arbitration, Real Estate, Anti-Trust, Dumping, Administrative Law, Privatization & Regulatory Agencies, Distribution, Agency & Franchising, Offset & Project Finance Operations, General Practice.

## General Information

Since 1938, L. O. Baptista Advogados has been acting in the main areas of Business Law, always based on values that became the firm's brand: technical excellence with strategic view, pragmatism, agility and commitment to the clients.

The firm's professionals are specialized in the most diverse areas of law and economy, many of which also act as professors, arbitrators or leaders of the most reputable domestic and foreign institutions in their respective fields.

📍 Avenida Paulista, 1294  
8º andar  
CEP 01310-100  
São Paulo - SP  
Brazil

☎ +55 11 3147 0800

✉ [svf@baptista.com.br](mailto:svf@baptista.com.br)

[www.baptista.com.br](http://www.baptista.com.br)

## • Companies

Brazilian law provides for different forms of association for the conduct of economic activities geared to the production or circulation of goods and services. Among the most usual are the corporation (“Sociedade Anônima S/A”) and the limited business company (LTDA), which are both subject to registration at the Commercial Board (“Junta Comercial”).

## • Corporations (S/A)

### REGULATION

Corporations are governed by their bylaws and by Law 6404/76 and are widely recommended when forming joint ventures in Brazil. The structure of a Corporation allows for the adoption of more robust corporate governance practices. The capital stock of a Corporation can also be controlled or fully owned by foreign legal entities and/or individuals. The registry is fulfilled when registered at the Registro Público de Empresas Mercantis (Junta Comercial).

### TYPES

It can be either: (i) closely held (securities are not traded on the stock market) or (ii) publicly held (securities are traded on the stock market, subject to Law 6,385/76 and the Normative Rulings issued by the Brazilian Securities Commission (Comissão de Valores Mobiliários - CVM)), which corresponds to the U.S. Security Exchange Commission (SEC).

### SHARE CAPITAL

There is no minimum limit. Exceptions: financial institutions and trading companies, for example. The capital can be paid with currency or assets. At least 10% (or 50%, in case of financial institutions) of the amount of capital subscribed in currency must be paid upon incorporation; the remaining amount must be paid during such term as set out in the Bylaws.

No minimum capital is required except for specific cases (financial institutions, trading companies, etc.). The Capital Structure follows the subsequent pattern: the capital is divided into shares, which can be either common or preferred shares, with or without a par value. Owners of shares can have their voting rights restricted and/ or be assigned additional economic benefits. A disproportional distribution of profits is not allowed by law, however, preferred shares may entitle shareholders to differentiated dividends. The number of non voting preferred shares may not exceed 50% of the company's total shares. The advantages of the preferred shares of privately held companies are: (i) priority in the distribution of fixed or minimum dividends; (ii) priority in stock redemption, with or without a premium; (iii) accumulation of the advantages of items (i) and (ii). Shareholders: Minimum number: 2. They are entitled to the mandatory dividend. Liability of Shareholders: Limited to the price of the subscribed or acquired shares. The corporation has a distinct existence from that of its shareholders. Hence it has capital autonomy in relation to the partners. It is the assets of the corporation that constitute the guarantee of creditors for debts incurred on its behalf. However, this rule is not absolute: for the protection of third parties, Brazilian legislation sets forth some cases wherein the partners are exceptionally accountable for the debts of the corporation. Examples: liability of the controlling shareholder for abuse of power in certain situations, the liability of partners for labor, tax and social security debts, liability for damages caused to consumers, liability for violations of the economic order (Antitrust Law), all arising from the application of the 'piercing the corporate veil' theory. These are exceptions established by law that cannot be quashed by a contractual provision. Transfer and assignment of shares: is free and does not depend on a by law change, operating by a term entered into the "Transfer of Registered Shares" book, dated and signed by the transferor and transferee, or their lawful representatives.

## **GENERAL SHAREHOLDERS MEETING**

Is the supreme body of the company. Convening quorum: in the first call, with the presence of shareholders representing a minimum of 1/4 of the voting share capital; in the second call, it will be called together with any number. Types: annual (AGO) and special (AGE). AGO: powers to: (i) receive the administrator accounts and approve the financial statements; (ii) decide on the appropriation of net profits for the year and the distribution of dividends; (iii) elect the administrators and members of the Audit Committee, if applicable. Frequency: annually, in the first 4 months subsequent to the end of the fiscal year. AGE: powers to: (i) reform the corporate by laws; (ii) authorize the issue of debentures; (iii) suspend the exercise of shareholders rights; (iv) approve the valuation of assets contributed by shareholders for the formation of the share capital; (v) authorize the issue of participation certificates; (vi) decide on the transformation, merger and spin off of the company, or its absorption into another; (vii) approve its dissolution and liquidation, elect and depose liquidators and decide on their accounts; (viii) authorize the administrators to declare bankruptcy and request for judicial reorganization. For the voting of the

following matters a qualified quorum is necessary, half the voting capital is needed for matters listed in Article 136 of the Corporations Acts; (ii) Simple majority is necessary for other matters. The Bylaws may require higher quorums for specific matters: a) creation of preferred shares or increase of existing classes of preferred shares, without maintaining a proportion with the other classes of preferred shares; b) alteration in the preferences, advantages and conditions of the redemption or amortization of one or more classes of preferred shares, or creation of a more privileged class; c) reduction of the mandatory dividend; d) merger by or of the company; e) participation in groups of companies; f) alteration of the corporate purpose; g) creation of the state of liquidation of the company; h) creation of participation certificates and (i) dissolution of the company. Frequency: whenever necessary. Reform of corporate by laws for: (i) a capital increase: requiring the prior opinion of the Audit Committee, if in operation. Types of increase: a) by capitalization of profits or reserves: implies the alteration of the par value of the shares or distribution to the shareholders of the new shares corresponding to the increase; b) by the public or private issue of shares: a condition for this type of increase is that at least  $3/4$  of the share capital has been paid up. The shareholders have the preemptive right for the subscription of the increase, in proportion to the number of shares held thereby; (ii) capital reduction: requiring the prior opinion of the Audit Committee, if in operation. Situations: a) loss up to the sum of accumulated losses; b) if excessive. Opposition of creditors: the reduction only becomes effective 60 days after the publication of the AGE.

## ADMINISTRATION

The management structure is composed by a Board of Officers (composed of at least two Officers, who must be an individual resident in Brazil) or a Board of Officers and a Board of Directors, as set forth in the corporate bylaws, furthermore they are responsible for the administration of the Corporation. All publicly held corporations, companies with authorized capital and quasi-public corporations must have a Board of Directors in place. Board of Directors: is responsible for fixing the generation of business and orientation of the company. It is composed of individuals, shareholders, residing in the country or otherwise (non residents shall necessarily have an attorney in fact in Brazil). Minimum number of members: 3. It is elected by the General Shareholders Meeting. Term of appointment: not more than 3 years, re election being permitted. Board of Executive Officers: is the executive body of the company and represents it before third parties. It is composed of individuals, shareholders or otherwise, residing in the country. Members of the Board of Directors, up to a maximum of  $1/3$ , may be elected for executive officer positions. Minimum number of members: 2. They are elected and can be removed at any time by the Board of Directors (when there is one) or by the General Shareholders Meeting (when there is no Board of Directors). Appointment term: not more than 3 years, re election being permitted. The corporate by laws may establish that certain decisions that are the prerogative of the officers shall be taken



in Board of Executive Officers meetings. In the event that the by laws are silent and in the absence of a decision of the Board of Directors, the representation and performance of the necessary acts for its regular operation will be the responsibility of any officer.

#### **RULES COMMON TO ADMINISTRATORS. INSTALLMENT TERM**

Remuneration: fixed by the General Shareholders Meeting, including benefits of any nature and representation fees, taking into account their responsibilities, the time devoted to their duties, their professional competence and reputation and the value of their services in the market. There is no minimum or maximum limit. Obligations: the administrator shall employ, in the discharge of his duties, the care and diligence that any active and honest man normally employs in the administration of his own business together with an obligation of loyalty. Acts prohibited to the administrator: (i) perform acts of liberality at the cost of the company; (ii) borrow resources or property of the company, without authorization, or use, to his own advantage, or to the advantage of a company in which he is a stakeholder, or of third parties, its assets, services or credit; (iii) receive from third parties, without the company's authorization, any kind of direct or indirect personal gain, by reason of the position held in the company. Liability: the administrator is not personally liable for the obligations that he incurs on behalf of the company and by virtue of a regular management act. However, he is civilly liable for the losses he causes, when he acts: I within his duties, with a negligent or fraudulent intent; II in violation of law or of the by laws.

#### **AUDIT COMMITTEE**

The corporation has an Audit Committee which may be convened, in case its operation is not permanent, in any general shareholders meeting. Its duties include: (i) to supervise the acts of the administrators and verify the fulfillment of their legal and by law obligations; (ii) to opine on the annual management report; (iii) to comment on the proposals of the administrative bodies to be submitted to the General Shareholders Meeting concerning, among other things, the modification of the share capital, distribution of dividends, transformation, merger by incorporation of companies, merger and spin off; (iv) to report to the administrative bodies or the General Shareholders Meeting the errors, frauds or crimes that it discovers and suggest courses of action that are useful to the company; (v) to analyze, at least quarterly, the trial balance and other financial statements drawn up periodically by the company; (vi) to examine and consider the financial statements for the fiscal year. Composition: Minimum of 3 and maximum of 5 members and alternates in an equal number, shareholders or otherwise, elected at the General Shareholders Meeting.

## FINANCIAL STATEMENTS

The law requires publication of many different documents (corporate documents, call notices and financial statements). Waiver: corporations with less than twenty shareholders and with an equity of less than BRL 1million. In general, the publications of a Corporation involve an average annual cost of BRL 45,000.00. The financial statements shall be available to the shareholders at least one month prior to the date scheduled for the AGO. They must be published in the Official Gazette and in a newspaper of general circulation during at least 5 days before the date scheduled for the AGO. They shall be the subject of the opinion of the Audit Committee, if in operation. They shall be submitted to the decision of the General Shareholders Meeting and subsequently filed in the Commercial Registry, along with the AGO minutes which approved them.

## PUBLICLY HELD COMPANIES

Are subject to specific rules in addition to the general rules applied to the private held companies. They are supervised by the Brazilian Securities Commission (CVM). The public distribution of securities cannot occur without prior registration at CVM. The sale of the control of a publicly held company is subject to the approval of CVM. Moreover, such companies shall have independent auditors and comply with a series of disclosures determined in the rules issued by CVM. Corporate Governance: Law 6404/76, which regulates corporations, was recently amended with the aim of increasing transparency and extending the rights of minority shareholders. Therefore, at least theoretically, there is the inclusion of rules that may be classified as corporate governance, including the following: (i) reduction in the capital of the company of the number of preferred shares without voting rights or subject to restriction in the exercise of such right; (ii) increase of advantages of the preferred shares of publicly held companies (iii) tag along: in the event of the sale of the direct or indirect control of a publicly held company, the acquirer will be obliged to conduct a public offering for the acquisition of the voting shares held by the other shareholders, at the amount equivalent to 80% of that paid per voting share of the control block; (iv) increase in the period of time preceding the publication of the General Shareholders Meeting to 15 days in the 1st call and 8 days in the 2nd call (the time for privately held companies is 8 and 5 days, respectively); (v) right to elect and remove a member and an alternate in the Board of Directors to shareholders with at least 15% of the total voting shares and to holders of preferred shares without the right to vote or with the restriction of the right to vote that represents a minimum of 10% of the share capital; (vi) inclusion of the spin off among the cases that entail the right of withdrawal, (if the spin off implies the reduction of the mandatory dividend, participation in groups of companies or changes in the corporate purpose); (vii) obligation of the controller of a publicly held company, of the shareholders and group of shareholders that elect a member of the Audit Committee to immediately appraise CVM, the Stock Exchange and organized over the counter entities of modifications to their

shareholder status in the company; (viii) in the event of the company becoming a private company, the controlling shareholder or the company itself must make a public offering for the acquisition of all the shares at a fair price; (ix) increased independence of the Audit Committee, permitting any member to supervise the acts of the administrators, verify compliance with the legal and by law obligations, and denounce any errors, frauds or crimes, suggesting courses of action that are useful for the company to the administrative bodies, and in case of failure to carry out the necessary measures, by such bodies, to the Shareholders' Meeting. Securities can be traded on the stock market if the corporation is publicly held. New rules for publicly held companies were introduced by the recent Law 11638/07, requiring them to draw up consolidated annual financial statements on the basis of international standards (IFRS – International Financial Reporting Standards).

- **Limited Companies (LTDAS)**

Limited Business Companies are created under articles of association which must provide for, among other things, the company's objectives and capital stock and the ownership interest of each partner. Generally, a Limited Business Company can perfectly operate a subsidiary whose capital is controlled or fully owned by foreign entities and/or individuals. They are particularly fit for smaller businesses. In forming the business relationship within a Limited Business Company, partners are given more freedom, including with respect to the distribution of profits. Are governed by their articles of association and by Law 10406/02 (Brazilian Civil Code). The registry is full-filled when registered at the Civil Registry of Legal Entities (Registro Civil das Pessoas Jurídicas).

**Partners:** Minimum of 2.

#### **SHARE (QUOTA) CAPITAL**

The capital can be paid with currency or assets. An initial payment of a minimum amount of capital subscribed in currency is not required. The capital is divided into ideal parts ("quotas") with a par value. The owner of a "quota" cannot be deprived of voting rights. Capital increase: only permitted after all the shares have been paid up. The pre-emptive rights of the partners to participate in the increase must be ob-

served, in proportion to their holdings. Capital reduction: The capital may be reduced by a corresponding change in the articles of association: (i) following payment, if there are irreparable losses; (ii) if excessive in relation to the company purpose. Transfer and assignment of shares: the transfer to third parties of shares or of the pre-emptive right to participate in capital increases requires the approval of partners representing at least 1/4 of the share capital (except if the articles of association determine otherwise). There is the need to change the articles of association.

## LIABILITY OF THE PARTNERS

Limited to the amount of the partner's ownership interest; however, all partners are jointly liable for the payment of the capital. The same provisions contained in the item "Liability of Shareholders", chapter SHARE CAPITAL in S/As, above, apply to LTDAs, in so far as the liability of partners is concerned. Moreover, the partners are jointly and severally liable for debts with the social security authorities, as well as for labor credits, as a result of the application, in these specific cases, of the 'disregarding the corporate entity' theory.

## ADMINISTRATION

One or more individuals who may be a partner of the company or not, provided that they are resident in Brazil. Appointment can be made either in the Articles of Association or in a separate document. The management structure (the existence of both the Board of Directors and the Board of Officers, or only the Board of Officers) must be defined in the Articles of Association. The designation thereof requires the unanimous approval of the partners (when the capital is not totally paid up) or of partners representing 2/3 of the share capital (when the capital has been paid up). Removal of a partner administrator: requires approval by partners representing at least 2/3 of the share capital. Remuneration: there is no minimum amount or maximum limit. The participation of partners in the company profits, in a different proportion to the partners' interest in the share capital is an option, provided that the Articles of Association or the partners' agreement so allows. Transformation of the company type, merger, merger by incorporation of companies and spin-off are allowed. Generally, no publication is required. Publication is required in the following cases: (a) call of a Meeting of Partners (for companies with more than ten partners); (b) minutes of the meeting of partners approving a capital reduction; and (c) balance sheet, economic results statement and management resolutions of any foreign company. The responsibility of the administrator of a LTDA before third parties, in principle follows the previously made comments applicable to the administrator of a S/A. However, in practice the administrators of LTDAs are being held to answer in the labor and social security field, jointly with the company, regardless of the cause of the event.

## RESOLUTIONS

The law requires (i) 100% of the capital for appointment of an administrator who is not a partner of the company, whenever the capital stock is not fully paid; (ii) 75% of the capital: (a) amendment to the articles of association; and (b) mergers, mergers by incorporation of companies, dissolutions and end of liquidations; (iii) 2/3 of the capital: appointment of an administrator who is not a partner of the company, whenever the capital stock is fully paid; (iv) More than half the capital: appointment of an administrator (in a separate document), his removal and remuneration, as well as any request for court-supervised reorganization; and (v) Simple majority for other matters provided for in the law or the articles of association. The Articles of Association may require higher quorums for specific matters. The decisions of the partners shall be taken in a partners meeting (for LTDAs with up to 10 partners) or in a general partners' meeting (for LTDAs with more than 10 partners). If omitted from the articles of association, the legal rules that discipline the general shareholders meetings of S/As will apply to the meetings. Securities cannot be traded on the stock market as a means to raise funds. This could only happen if the Company is transformed into a publicly held Corporation.

## EXCLUSION OF PARTNERS

The law provides for the possibility of the non judicial exclusion of a partner who jeopardizes the continuity of the company, by virtue of acts of undeniable gravity, as resolved by the partners representing more than half of the share capital, as long as the articles of association provide for exclusion for good cause and the legal procedures are observed.

## FINANCIAL STATEMENT

Generally, no publication is required. Publication is required in the following cases: (a) call of a Meeting of Partners (for companies with more than ten partners); (b) minutes of the meeting of partners approving a capital reduction; and (c) balance sheet, economic results statement and management resolutions of any foreign company. Nevertheless, large-sized limited business companies are required to have their financial statements published. Large-sized companies mean a large-sized company or group of companies under common control whose assets exceeded BRL 240 million or whose gross revenue exceeded BRL 300 million in the preceding fiscal year.

## CHOICE

With the provisions brought by the new Civil Code, many of the advantages that previously existed for LTDAs have disappeared, notably their structuring flexibility. This should lead to greater reflection in regards to the choice of company type: LTDA or S/A. The choice will depend on each specific case, but by and large, one

may say that LTDAs work very well for the operation of subsidiaries whose total quota capital is held by foreign companies, whereas possible joint ventures in Brazil should elect for the adoption of a S/A, owing, among other things, to the legal security conferred by the already officially accepted interpretation of the rules that govern this type of company.

## • Branch Offices of Foreign Companies

A foreign company may directly operate in Brazil through a branch office, i.e. through an extension of the foreign corporate entity itself. However, this procedure presents some disadvantages in comparison to the establishment of a business concern in Brazil through ownership interests, for the following reasons:

- The need of prior authorization, through an act of the Federal Executive Branch— a slow and highly bureaucratic procedure.
- Prohibition of the remittance of royalties to the head office abroad for the use of trademarks and exploitation of patents.
- Tax disadvantages.

## • Corporate Reorganization Operations and Sale of Establishments

Corporate reorganization operations may be conducted both by Corporations (“Sociedades Anônimas”) and by Limited Business Companies (“Limitadas”). These operations include:

1. Transformation: the company is transformed from one type of company to another, without the dissolution or interruption of its activities.
2. Merger: two or more companies are combined to form a new company, which succeeds them to all their original rights and obligations.
3. Spin-off: the company transfers portions of or even its total equity (assets and liabilities) to one or more companies, with the continuation of the spun-off company, if its equity has been partially transferred, or with its extinction, if all its equity has been transferred. The law stipulates specific succession rules for the obligations of the spun off or extinguished company.
4. Merger by incorporation: one or more companies will be absorbed by another company, which succeeds them to all their rights and obligations.

S/As and LTDAs may further sell their industrial or commercial establishments, in which case the acquirer will succeed to all their respective rights and obligations.

## • Acquisition of Companies

The total or partial acquisition of a Brazilian company by a foreign company may occur through many different types of transactions.

Without prejudice to other types of transactions that may be recommended in proper tax planning, we highlight, (i) the acquisition of shares or quotas of capital stock of the Brazilian company; (ii) the subscription of new ownership interest as a result of a capital increase by the company involved; and (iii) the acquisition of establishments, assets, and/or goodwill (“fundo de comércio”).

In the light of the topic “acquisition of companies”, the possibility of setting off the premium paid by the acquirer is of significant importance and must necessarily be analyzed by a skilled professional, particularly when it comes to assessing the tax risks involved. 15.2. Pre-investment caution

Whatever method is adopted for the acquisition, special care should be taken by the foreign investor, particularly with respect to the following:

1. A thorough analysis of the financial and legal situation of the prospective local partner (in the case of a joint venture);
2. A detailed analysis of the financial, accounting, and legal situation of the company involved, as well as a detailed analysis of the market in which it is engaged, by professionals specialized in the Brazilian laws (financial, accounting, and legal audits conducted by investment banks, independent auditors and specialized attorneys);
3. The accurate identification of liabilities and contingencies of the company to be acquired – a crucial step to define which representations and warranties will be given by sellers with respect to the company, its businesses and assets– ; definition of the responsibilities for losses regarding events occurring prior to the transaction; setting of the price and any application withholdings; definition of guarantees and/or escrow; among other protective measures to be taken by the investor;
4. Assessment of the best structure, in terms of its tax and corporate aspects, to be used for the intended transaction, especially in relation to any premium to be paid;
5. Assessing whether it is necessary to submit the transaction to the Brazilian antitrust authorities or any third parties with whom the company has a contract (change of control clause); and
6. Analysis of issues regarding compliance and anticorruption.

Depending on the transaction, (binding or non-binding) letters of intent, acquisition instruments, shareholder or associate agreements, agreements with officers, guarantee agreements, and other documents will have to be negotiated between the parties

## • Consortium

Different organizations, S/As or LTDAs, under the same control or otherwise, may set-up a consortium to carry out a specific undertaking.

Through a consortium several companies (Corporations or Limited Business Companies, whether or not under common control) associate with each other to carry out a specific undertaking, being able to assume certain activities, which could not be carried out individually by each company, especially due to technical or economic financial conditions. This type of association is frequently used in public bids and for the concession of construction works and private and public services, import and export.

A consortium is not a corporate entity and, as a general rule, its members are only bound under the conditions provided for in its incorporation agreement, without the presumption of joint and several liability.

This rule does not apply to the obligations pertaining federal taxes; in this case, the member companies will be jointly responsible for these obligations. Depending on each case, member companies may also incur joint and several liability with respect to labor, tax (other than federal taxes) and consumer-related obligations.

The consortium incorporation agreement and its amendments must be filed at the Registry of Commerce (Junta Comercial) of the venue of its headquarters.

## • Undisclosed Joint Venture Partnership (SCP)

It consists merely of a private agreement, entered into by two or more participants, with the purpose of permitting the exploitation of a specific business opportunity or specific business activity. It is commonly used in specific transactions such as import, export, participation in specific businesses, public bids, among others.

The law differentiates two types of participants: (i) the visible partner: develops the component activities of the company purposes in his individual name and assumes responsibility for the company obligations in an exclusive manner, and (ii) the secret partner: appears merely as an investor, not appearing to third parties; assumes responsibility towards the visible partner within the limit provided in the company's formation instrument.

An SCP is not a separate legal identity different from that of their participants and its formation is not subject to any formality. Proof of existence of an SCP can be made by means of any evidence permitted by Brazilian law.



## GENERAL NOTES

The taxing power is shared by the Federal Government, the States, the Federal District and the Municipalities. For this purpose, a series of rules was created, which together constitute the Brazilian Tax System, namely: the Federal Constitution, National Tax Code and federal, state and municipal legislation.

## SIGNIFICANT DEVELOPMENTS

The National Tax System has been undergoing improvements in order to cover practically all the activities of corporate entities.

### ► Taxes on corporate income

*These taxes are imposed on a federal level and can be summarized as follows:*

#### **IRPJ (Corporate income tax)**

Assessed on the acquisition of the economic or legal availability of income (the product of capital and labor or the combination of both) and of proceeds of any nature. The rate is 15% with a surtax of 10% levied on income in excess of R\$ 240 thousand (approximately US\$ 76 thousand in August 2017) per year.

#### **CSLL (Social contribution on net profits)**

Levied at a tax rate of 9% on taxable profits. The contribution rate corresponds to 20% in the case of legal entities considered financial, private insurance and capitalization institutions.

#### **PIS (Contribution to the social integration program)**

Assessed on the monthly gross receipts of corporate entities. It may be computed in a cumulative regime, at the rate of 0.65%, or non cumulative regime, at the rate of 1.65%. In the latter case, the sum collected in certain prior operations is discounted on each successive operation and there are some deductions of the gross receipts determined by law.

#### **COFINS (Contribution for the funding of social welfare programs)**

This is also levied on monthly gross receipts and may also be computed in a cumulative regime, at a tax rate of 3% or non cumulative regime, at a tax rate of 7.6%; subject to legal limits and requirements. PIS and COFINS are determined and collected on the same tax basis.

## CORPORATE RESIDENCE

This is determined with regard to the location of the company's assets and where the facts giving rise to the tax obligation occur (company's registered office and/or main place of business).

## ► Federal Taxes

### IPI (Equivalent to the Excise Tax)

Its taxpayers are, for example, importers and industrial companies. Its tax rate, which is applicable on the amount of each operation, varies in accordance with the product. There are a number of tax benefits to stimulate the industrial sector, as well as the construction sector.

### II (Import duty)

is levied on import operations. This tax has variable rates according to the product being imported.

### IOF (Tax on credit, insurance and foreign exchange operations, or on operations relating to negotiable instruments and securities)

Its taxpayers are, for example, importers and industrial companies. Its tax rate, which is applicable on the amount of each operation, varies in accordance with the product. There are a number of tax benefits to stimulate the industrial sector, as well as the construction sector.

## ► State Taxes

### ICMS (Equivalent to VAT)

Is levied mainly on the circulation of goods, including those imported from abroad; interstate and inter municipal transport services and communication services. Its rates vary from 4% to 25% of the operation amount, in accordance with the type of goods sold or the service rendered and according to the internal legislation of the State where the company taxpayer is located. In most cases, the rate is 18%. It is non cumulative.

### ITCMD (Transfer Tax)

Is assessed on the transfer of any property by will, inheritance or gift made between individuals or corporate entities. The rate on the market value of the property donated or received as an inheritance varies according to the State. In the State of São Paulo the rate is 4%. The maximum percentage allowed for every States is 8%.

## ► Municipal Taxes

### ITBI (Inter-Vivos Property Tax)

Is levied mainly on the circulation of goods, including those imported from abroad; interstate and inter municipal transport services and communication services. Its rates vary from 4% to 25% of the operation amount, in accordance with the type of goods sold or the service rendered and according to the internal legislation of the State where the company taxpayer is located. In most cases, the rate is 18%. It is non cumulative.

### IPTU (Urban Property Tax)

Is assessed on the transfer of any property by will, inheritance or gift made between individuals or corporate entities. The rate on the market value of the property donated or received as an inheritance varies according to the State. In the State of São Paulo the rate is 4%. The maximum percentage allowed for every States is 8%.

### ISS (Service Tax)

is levied on the provision of the services contained in the list attached to Complementary Law 116/03, regardless of whether the services constitute the core activity of the provider. The rate varies from 2% and 5% and is defined by the Municipality where the establishment is located or where the service is carried out, according to each individual case.

## ► Capital Tax and Stamp Duty

*These are not provided for in the legislation.*

## BRANCH INCOME

Subject to the same rules set forth above. Branches in Brazil are not allowed to take deductions related to expenses paid or credited to the headquarters as royalties, technical, administrative or similar support.

## INCOME DETERMINATION

Actual income determined in the annual balance sheet at December 31 or in quarterly trial balances. Presumed income percentage of the quarterly gross receipts of the corporate entity, without any deduction, for the purposes of the calculation of IRPJ and CSLL (corporations whose total gross receipts in the preceding calendar year were not higher than R\$ 78 million, equivalent to US\$ 24 million in August 2017, may elect for this regime).

## DEDUCTIONS

From the income tax determined for the month under the actual income, the tax paid or withheld at source on income included in the tax basis, and the deduction incentives related to the Workers' Food Program, Children and Adolescent Funds and Cultural, Artistic and Audiovisual Activities may be deducted. Additionally, there are some costs and expenses that are deductible for the determination of actual profit:

- Depreciation, amortization and depletion: The amounts related to the decline in the value of asset items resulting from wear and tear, as a result of nature and normal obsolescence (depreciation), recovery of the capital invested, or of the resources invested in the formation expenses of the result for more than one taxable period (amortization) and decline in the value of mineral and forestry resources, resulting from their exploitation (depletion), may be computed as a cost or charge in each taxable period.
- Net operating expense: The expenses that are not computed in costs, necessary for the company's business activity, paid on the transactions undertaken are operating expenses and deductible.
- Payments to foreign affiliates (transfer pricing): The respective costs, expenses and charges relating to goods, services and rights are deductible for the determination of actual profit up to the price determined by one of the methods provided in law.
- Taxes: Deductible from actual profit according to the accrual basis of accounting.
- Other significant items: The provisions and allowances provided in law (technical, vacation pay, thirteenth salary and provision for income tax) are deductible.

## GROUP TAXATION

There is no legal provision for group taxation; each company is taxed in separate.

## TAX INCENTIVES (INCLUDING SPECIAL TAX REGIMES)

Industrial Technological and Agricultural Development Programs (PDTI and PDTA), to foster the technological qualification of industries and agriculture. There are tax regimes linked to the importation and exportation of goods and tax benefits for industrialization and commercialization in certain Brazilian regions.

## WITHHOLDING TAXES (IRRF)

Below is a table with some of the main percentages:

Remittance Abroad Cases	Current Rate	Current rate for Tax Havens
Profits and dividends	0	0
Interest	15%	25%
Royalties, or remuneration for technical or similar services or of payment for contracts with or without technology transfer, except if there is an agreement to avoid double taxation.*(a)	15%	25%

**\*(a): For the purposes of the application of the Brazilian tax legislation, tax havens are construed as countries or dependencies with the taxation of income at a rate or less than 20%:**

Andorra, Anguilla, Antigua and Barbuda, Aruba, Ascension Islands, Commonwealth of the Bahamas, Bahrain, Barbados, Belize, Bermudas Islands, Brunei, Campione D'Italia; Channel Islands (Alderney, Guernsey, Jersey and Sark), Cayman Islands, Curacao, Cyprus, Singapore, Cook Islands, Republic of Costa Rica, Djibouti, Dominica, Erin, United Arab Emirates, Gibraltar, Granada, Hong Kong, Kiribati, Labuan, Lebanon, Liberia, Liechtenstein, Macau, Madeira Islands, Maldives, Isle of Man, Marshall Islands, Mauritius Island, Monaco, Montserrat Islands, Nauru, Niue Island, Norfolk Island, Panama, Pitcairn Island, French Polynesia, Queshm Island, American Samoa, Independent State of Samoa, San Marino, Saint Martin, Islands of St Helena, St. Lucia, Federation of St. Kitts and Nevis, Saint Pierre and Miquelon Island, St. Vincent and the Grenadines, Seychelles, Solomon Island, Swaziland, Sultanate of Oman, Tonga, Tristan of Cunha, Turk and Caicos Islands, Vanuatu, Virgin Islands of the United States, British Virgin Islands.

## TAX ADMINISTRATION

Is carried out by the Brazilian IRS and by the State and Municipal Treasuries, according to the respective taxing power.

- Returns: Obligation depends on each tax and State/Municipality involved.
- Payment of tax: IRPJ and CSLL Quarterly or annual, with the adjustments provided in law; IPI/ICMS/ISS/PIS/COFINS monthly; and II at the time of customs clearance.

## • Individual Taxes

### GENERAL NOTES

Individuals residing in Brazil are subject to tax on the worldwide income.

### TERRITORIALITY AND RESIDENCE

The tax domicile of an individual is generally construed as his or her habitual residence, provided that there is the requisite intention to maintain such a residence. There are specific criteria and conditions though.

### GROSS INCOME

Product of capital, labor or the combination of both, alimonies and personal allowances in cash, proceeds of any nature (increases in patrimony that do not correspond to the declared income, are also included).

#### ► Employee Gross Income

*Taxed in the month that the resources are received by the paying source, even by means of a deposit in a financial institution in favor of the beneficiary. This is calculated with the use of the following progressive monthly table:*

Tax basis in US\$	Current Rate	Portion to be Deducted from the Tax in US\$
Until 605.13	0	0
From 605.14 to 898.38	7.5%	45.39
From 898.39 to 1,192.17	15%	112.76
From 1,192.18 to 1,482.54	22.5%	202.18
Over 1,482.55	27.5%	276.30

\* US\$ on August 2017.

#### ► Capital Gains and Investment Income

*Income tax is due on the capital gains on the sale of property or rights, determined by the positive difference between the sales value and the acquisition cost, at the a progressive rate corresponding to 15% to 22,5%.*

#### ► Capital Losses

*There is no provision for the taxation or deduction in Brazilian legislation.*

## MONTHLY DEDUCTIONS

Social security contributions, expenses in the cash book, US\$ 60.26 per dependent and US\$ 605.13 of allowances and pensions of persons over the age 65, per month.

### ► Deductions in Returns

*Incentives for cultural and artistic activities (gifts and sponsorships), gifts and funds controlled by the Councils of Rights of Children and Adolescents, medical and education expenses, contributions to Pension Plans.*

### ► Simplified Discount

*The taxpayer may elect for the simplified discount, which consists of the deduction of 20% of income, limited to US\$ 5,324.92, in the Annual Adjustment Statement, with the proof of the expense and indication of its type being not necessary.*

### ► Personal Allowances

*These may be deducted if necessary in order to comply with a judicial decision or judicially ratified agreement, including the payment of provisional alimony.*

## TAX CREDITS

Credits for foreign taxes paid are allowed.

## OTHER TAXES

### ► Social Security (INSS)

*The employees' contribution, discounted from their salary, is calculated by the application of the corresponding rate (could be until 11% of the amount paid by the company, limited to USD 193,38), on their monthly contribution salary. For other taxpayers affiliated to the General Social Security Regime, the contribution is 20% of the contribution salary in the company level, subject to the deductions set forth in law.*

### ► Wealth Taxes

*Though provided for in the Constitution, this tax has not been introduced yet*

# Brazil | FOREIGN INVESTMENT

## DIRECT INVESTMENT

Assets, machinery and equipment brought into the Country without an initial outlay of foreign currency, to be employed in the production of goods or services, and financial or monetary resources admitted into the Country for investment in business activities, are considered foreign capital, provided that in both cases they belong to individuals or corporate entities residing, domiciled or based abroad, and must be registered electronically with Central Bank of Brazil (BACEN), through an investor-recipient related code called RDE-IED, which was initially instituted through the repealed BACEN Circular 2,997 of 11 August 2000, and is currently ruled by Resolução 3.844, of March 24, 2010 (“Resolução 3.844”) and Circular 3.689, of 16 December 2013 (“Circular 3.689”), both issued by the BACEN. Circular 3,689 was recently amended by Circular 3,814 of 7 December 2016 (“Circular 3,814”) with respect to the procedures required for registering foreign investment capital with BACEN.

This registration is made in the IED module of the RDE in the Electronic Central Bank System – SISBACEN, on the BACEN website. As mentioned above, an investor-recipient code RDE-IED is assigned to each pair of foreign investor and related Brazilian company, and the following information must be provided: initial investment, changes to the net shareholders’ equity, changes to the recipient’s paid capital and the percentage of paid capital held by each foreign investor and any subsequent change, as well as economic and financial statements.

Registration at BACEN is a condition for the remittance abroad of profits and dividends, and interest on owners’ equity, obtained by means of investments made in the Country and guarantees the investor the possibility of repatriating the resources invested.

The investor can also invest in Brazilian companies through the conveyance of tangible goods (machinery and equipment), provided that such goods are imported, without the obligation of a payment to a nonresident. In this case, the registration must be made, firstly, in the ROF – Registro de Operação Financeira (Financial Operation Registration) module of the RDE, and, subsequently, in the IED module of the RDE as foreign direct investment. This Registration in the RDE-ROF module must be linked to the cleared Import Declaration (Declaração de Importação – DI).

In addition to investments in corporeal property to be employed in the production of goods and services, BACEN also accepts such intangible goods as trademarks, patents and know-how, as the subject of investment as foreign capital. The registration of intangible goods in BACEN should also be done through the

RDE-ROF module, linked to an invoice or equivalent document that characterizes the importation of the intangible goods, provided that approved by the agency responsible for the registration and control of industrial property rights in the Country, namely the INPI (Brazilian Patent and Trademark Office). Finally, the registration is conducted in the RDE-IED module.

According to the Circular 3.689 rules, the technology transfer subject to INPI registration does not characterize an intangible good for the purposes of the financial operation registration designed for the payment of the capital of Brazilian companies.

The foreign investor may also make investments through the conversion of credits that are capable of generating transfers abroad, such as foreign loan principal and interest duly registered in the RDE-ROF Module, profits or dividends, interest on owners' equity and other amounts remittable abroad.

On the basis of the declarations and data informed electronically to the Electronic Central Bank System – SISBACEN, by companies or their representatives, a Consolidated Foreign Direct Investment Registration Statement will be generated. This statement is the appropriate document to evidence the investment made by the foreign investor before third parties.

The investment registration procedure shall be formalized within 30 days from the investment's entry into Brazil. In relation to foreign investments through tangible goods, the registration period is 30 days from the customs clearance date of the goods, on pain of submitting the recipient company of the investment to the application of a fine of up to R\$250 thousand, in accordance with the provisions of the Resolução 4.104, of June 28, 2012, issued by BACEN.

The aforesaid registration will be made in the foreign currency actually brought into the Country or in the amount declared in the import document of the goods.

Circular 3,814 changed the method of registration of foreign investment capital with SISBACEN to require that, based on the information contained in the foreign exchange contract or international transfer of sums in Real, an automatic registration is made in the IED module of the RDE in case sums are remitted to Brazil as a result of the following events: (i) currency remitted from abroad; (ii) conversion of other type of registration into direct foreign investment; (iii) any transfer between different registration types; (iv) international transfer of shares; and (v) remittance of profit, dividend, interest on owners' equity, or return of capital, to abroad. Although registration is automatic in the events above, the recipient must, within thirty days from any event changing the ownership interest of the foreign investor, update the amounts of net shareholders' equity and paid capital as well as the amount of capital paid by each foreign investor.



Circular 3,814 also determines that the investments arising from the events below are registered through a statement entered in the IED module of the SISBACEN RDE – not automatically: (i) remittance of tangible and intangible assets from abroad for the purpose of capitalization by the recipient; (ii) corporate reorganizations – i.e., merger, merger by incorporation of companies or spin-off – occurring in Brazil and involving at least one company with foreign capital registered with BACEN; (iii) exchange of shares in Brazil, which means any exchange of ownership interests in Brazilian companies, one of which must be a recipient of direct foreign investment registered with BACEN, whenever such exchange is made between a domestic investor and a non-resident investor or between non-resident investors; (iv) transfer of shares in Brazil, which means the transfer of fully paid shares of a Brazilian company held by a non-resident investor for the payment of the shares subscribed by such non-resident in another Brazilian company; (v) reinvestment, which means the capitalization of profit, dividend, interest on shareholders' equity and profit reserve in the recipient company that generated them; (vi) distribution of profit/dividend, payment of interest on shareholders' equity, sale of ownership interests, return of capital and net assets as a result of liquidation, whenever they are used as reapplication in another Brazilian company; (vii) distribution of profit/dividend, payment of interest on shareholders' equity, sale of ownership interests, return of capital and net assets as a result of liquidation, whenever they are used in payments in Brazil or direct payments abroad.

Foreign investors with ownership interests in Brazilian companies may transfer these interests to third parties abroad. The foreign purchaser, notwithstanding the price paid for the acquisition, must alter the Consolidated Foreign Direct Investment in Brazil Registration Statement, obtaining a new RDE-IED registration number, which will identify its investment in substitution of the assigning investor, in order to permit future remittances, profit reinvestment registrations and any repatriation of the investment.

Lastly, it is important to mention that individuals or companies domiciled or based abroad, that have ownership interests and other assets in Brazil are obliged to register in the CPF (Federal Register of Individual Taxpayers) and CNPJ (Federal Register of Corporate Taxpayers), respectively.

► **Economic and Financial Info**

*These taxes are imposed on a federal level and can be summarized as follows:*

- |  |  |
|--|--|
| <p>a. Recipients of foreign capital, except those described in letter "b" below, will have until 31 March of each year to update in the BACEN system their information on the net shareholders' equity and the sum of capital stock paid by each investor based on the balance sheet of December 31 of the preceding year.</p> | <p>b. Recipients of foreign capital with assets or net shareholders' equity of BRL 250,000,000.00 (two hundred and fifty million Reais) or greater must update their economic and financial information registered with the BACEN system quarterly, according to the schedule:</p> |
|--|--|

Information disclosure base date	Information disclosure base date
31 March	30 June
30 June	30 September
30 September	31 December
31 December	31 March

*The economic and financial information to be submitted must include: (i) amount of paid capital; (ii) net shareholders' equity; (iii) assets; (iv) liabilities; (v) Net profit (+)/losses(-) for the base period; (vi) profit distributed during the based period; (vii) estimated company value; (viii) valuation method; (ix) investor's registration number with Brazilian Ministry of Finance (CPF/CNPJ); (x) information on the investor such as voting power, country of origin, and country of destination.*

## FOREIGN INVESTMENT IN LOCAL CURRENCY

In 2007, BACEN published new foreign exchange rules permitting the registration in local currency of ownership interests held by a foreign partner, which, up to that time, could not be made at BACEN, due to there being no evidence of the regular entry of the resources into the Country (via the contracting of foreign exchange, as determined in the prevailing foreign exchange regulations). This situation was known as "tainted capital" (capital contaminado). The consequence of this situation, among others, was that of not permitting the remittance of profits and dividends abroad on the unregistered portion of the capital/investment.

In accordance with the new rules, foreign capital should only be registered with BACEN, in local currency, if the respective amount is stated in the accounting records of the Brazilian recipient company of the foreign capital, and if there is documentary evidence with respect to the ownership of the foreign capital.

Once the registrations are regularized with BACEN, the foreign investor is authorized to return abroad the total computed profits and dividends, among others, up to the limit of the holdings held in the company.

Lastly, the capitalization of profits and dividends, interest on owners' equity and profit reserves, originating from the portion of the capital registered in local currency, are subject to the same registration modality.

## INDIRECT INVESTMENTS: FOREIGN LOANS

### ► Foreign Loans Via the Free Exchange Rate Market

*The foreign loan contracting process is conducted through the electronic declaratory registration, by means of the Financial Operation Registration Module (ROF) of SISBACEN, which dispenses with the presentation of documents to BACEN, prior to the receipt of the loan resources. The electronic registration is thus prepared through the declarations and data informed electronically*

in SISBACEN, in two phases: (i) prior registration, relating to the general conditions of the operation, to allow for the entry of resources into the Country and (ii) registration of the payment scheme, done after the closing of the foreign exchange and entry of the resources into the country, enabling remittances to be made abroad as payment, both of the principal and interest.

It is important to mention that the aforementioned prior registration may be denied by the system, if the costs of the operation are not compatible with normal market conditions and practices or if the proposed structure of the operation is not compatible with the standards of the system.

BACEN does not currently call for any minimum or maximum average term for the debt amortization and repayment of the loan principal, or for the renewal and extension of loans. However, such terms may be fixed by BACEN in accordance with the Country's current foreign exchange and monetary policy. The interest varies in accordance with the term contracted, and may be fixed or variable, or even non-applicable, provided that, as previously mentioned, they are within the parameters prevailing in the international market. Spreads are also permitted.

Still in relation to the interest, the term for its calculation will begin to run on the date that the funds enter the Country, namely, the settlement date of the foreign exchange contract. However, when the disbursement of the funds abroad occurs up to five (5) consecutive days before their entry into the Country, the disbursement date may be used as the initial date for the reckoning of the term.

After the entry of the funds into the Country, the payment scheme must be registered, in order to permit remittances of the payments of the interest and principal abroad.

As a general rule, the interest will be taxed by withholding income tax, at the rate of 15%. This rule, however, is subject to many exceptions depending on some factors such as the type of loan and the jurisdiction of the creditor (tax haven or non-tax haven jurisdiction) and also depending on the existence of a double taxation agreement applicable to the case.

The Tax on Financial Operations – Currency Exchange (IOF – currency exchange) is currently zero upon entry of the principal for loans exceeding 180 days, and 6% for operations under the time limit mentioned above. No Tax on Financial Operations - Exchange (IOF - exchange) is levied on the repayment of the principal or payment of interest. Because the rules applicable to this tax are constantly changing, it is important to check which rules are in force before concluding the operation.

If it does, there is no TFO on the principal amount. When the principal amount and interests are paid, there is no TFO, regardless of the term of the loan. We emphasize that such parameters are often subject of amendments, which can be in effect from their publication by decree.

Loans (principal and interest) may, as a general rule, be converted into foreign direct investment, after their registration in the ROF, by means of the performance of simultaneous foreign currency purchase and sale operations. However, it is important to take into account the consequences of such conversion in terms of income tax and the Tax on Financial Operations - Exchange (IOF - exchange).

The accelerated payment of the loan principal (either total or partial) is permitted, it being sufficient to include, in the ROF, the payment date of the principal and interest, and the sum of the interest due up to the payment date.

#### ► Foreign Loan Through the Issue of Securities

Resolução 3.844 and Circular 3.689 regulate the electronic declaratory registration, by means of the Financial Operation Registration Module (ROF), of foreign loan operations obtained by means of the placement of convertible securities (issued by an institution based in the Country and

placed abroad, which represent rights over shares or quotas of its own issuance) and securities exchangeable into shares or quotas (issued by an institution based in the Country and placed abroad, which represent rights over shares or quotas issued by another institution based in the Country) or also warrants (purchase options of shares or quotas, placed abroad by institutions based in the Country).

Moreover, BACEN legislation also establishes that, prior to the date of the conversion, exchange or exercise of the purchase option by the holders of warrants, the distribution of dividends and exercise of subscription will constitute rights of the issuer institution of the securities abroad.

Promissory notes issued for placement in the international market, whether under the private placement regime or otherwise, are known as Floating Rate Notes or Fixed Rate Notes, depending on whether their remuneration is stipulated in variable or fixed interest.

The entity issuing the notes does not require a specific legal form or special registration for their issuance, and BACEN is directly and exclusively responsible for their control, in the same format as loan registrations. However, the difference lies in the existence of an issuing agent figure of the notes, which shall necessarily be an authorized financial institution, responsible for issuing and obtaining funds from entities abroad.

### ► Foreign Exchange Market

In 2005, BACEN published new rules with a view to simplifying foreign exchange operations in Brazil, indicating the probability of a future complete foreign exchange opening, which, to this date, has not yet occurred. Additionally, the measures in question are designed to combat illegal transfers linked to drug traffic, armaments and terrorism. The main rules currently in force are:

- Unification of the free and floating rate markets;
- Individuals and corporate entities may purchase and sell foreign currency or make transfers of any nature, without a limitation of value; however, transfers in the name of third parties are prohibited;
- Brazilian investment abroad, regardless of BACEN authorization, and is not subject to any limitation of value;
- Nonresident individuals or corporate entities in Brazil may maintain accounts in the Country called "nonresident accounts", with financial institutions authorized by BACEN to operate in Brazil; however, the use of such accounts to make transfers in the name of third parties is forbidden.

### ► Local Currency Loans

In 2007, BACEN published new foreign exchange rules permitting the registration in local currency of foreign loans, which, until that time, could not be registered at BACEN, due to the non-existence of evidence of the regular entry of the resources into the Country (via the contracting of foreign exchange, as determined in the prevailing foreign exchange regulations). The direct consequence of this situation was that the borrower of the resources in Brazil was precluded from remitting to the foreign creditor the interest due on the loan or the principal itself.

Nevertheless, in accordance with the new rules, as long as documentary evidence exists with respect to the ownership of the foreign capital (i.e., in the name of the foreign creditor) and the indication of the number of the operation conducted via International Transfer in Reais ("TIR") through which the resources were remitted to the country, the same may be registered with BACEN, in the local currency loan registration modality, according to the terms and criteria established by BACEN

*Thus, once the registrations are regularized, the borrower of the resources may remit abroad the respective interest due or the principal itself.*

## **REMITTANCE OF PROFITS AND DIVIDENDS TO INVESTORS DOMICILED ABROAD**

Once the foreign capital has been registered with Central Bank of Brazil (BACEN), profits may be freely remitted to the foreign investor abroad, in proportion to its holdings in the paid-up capital of the Brazilian company and always limited to the stake registered with SISBACEN, RDE-IED Module. Remittances must also have their movement registered with BACEN and will be exempt from any taxation, except the rate of 0,38% corresponding to the IOF – Tax on Financial Operations levied on the amount to be remitted abroad.

## **REPATRIATION OF INVESTMENT**

As a general rule, capital and reinvestments registered with BACEN may be repatriated to the investor's country without incurring income tax, up to the total foreign currency amount stipulated in the Consolidated Investment Statement available on the BACEN RDE-IED System. However, depending on the specifics of the case at hand, Brazilian tax authorities may give a different interpretation: it may consider capital gain as the positive difference, in Brazilian currency (Real), between the sale price and the purchase cost.

Therefore, with due observance of the ownership interest of the foreign investor in the capital stock of the Brazilian company, the allocation of resources determined in the sale of ownership interests, reduction of capital for the reinstatement of shareholders or liquidation of companies, shall be registered with BACEN.

The differences in excess of amounts registered as brought into the Country or the amount as otherwise proven to be the cost of purchase of the Brazilian asset – such as the case of a premium verified on the sale of shares – will be considered “capital gain” and, as a rule, be subject to the levy of income tax at the rate of 15%. This rule, however, is subject to many exceptions depending on some factors such as the type of asset that is being sold and the jurisdiction of the seller. This is why a thorough analysis of each individual case is essential.

BACEN may, if it deems necessary, ask for the presentation of an appraisal report, as well as other elements it considers relevant for the perfect characterization of the operation and verification of the reasonability of the amounts involved.

## **FOREIGN PERSONNEL**

Law 6,815/1980, regulated by Decree 86,715/1981, defines the legal status of the foreigner in Brazil and creates the National Immigration Council.

There are different types of visas for foreigners, their spouses and economically dependent children, the most common of which are:

► **Business Visa**

*The visa for business travelers, which can be obtained from any Brazilian Consulate, enables the foreigner to come to Brazil for acts of commerce, the dissemination of products and market research. This modality also permits participation in trade shows, events, meetings, seminars, conferences and similar events, for the short term and with no intent of residence.*

*The business visa is normally granted for up to five years, permitting multiple entries for citizens of countries that offer, on a reciprocity basis, similar conditions to Brazilian citizens. This period, however, refers to the validity of the visa.*

*The first entry in the country should occur within up to 90 days of the issuance of the visa and the maximum permitted stay in the country is for up to 90 days, extendible for an equal period. However, the foreigner's total stay cannot exceed 180 days per year, as from the date of first entry into Brazil. Remuneration of the visitor is forbidden.*

*Remuneration of the visitor is forbidden. Brazil maintains reciprocity agreements with certain countries (such as those of the European Union and Mercosur) dispensing with this type of visa.*

*Foreigners who are not required to take out a visa for a business trip may enter Brazil by presenting their passports and informing business purpose on the immigration card distributed during international flights to the country.*

► **Temporary Work Visa**

*Temporary work visas will be granted to foreigners who come to Brazil to work for a Brazilian company in the capacity of employees, i.e., with an employment relationship and upon remuneration by the Brazilian company, but without representation powers of the company. This visa will be granted for a maximum period of 2 years. After such period, the temporary visa may be transformed into a permanent visa, provided that certain legal requirements are met. If the temporary visa is originally granted for a period of less than 2 years, then it may be renewed up until it reaches such 2-year period.*

*In accordance with Normative Resolution 99/2012, of the National Immigration Council (Conselho Nacional de Imigração), to apply for a temporary visa, the foreigner shall evidence professional qualification and experience compatible with the activity he or she will be performing, by presenting diplomas, certificates or declarations from entities in which the employee performed his or her activities, evidencing the satisfaction of one of the following requirements:*

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|--|---|---|
| <p>a. 1 year experience in the practice of a high level profession, counted from the completion of the first academic degree that qualified the professional for this practice, or</p> | <p>b. 2 years experience in the practice of a mid level profession, with minimum schooling of 9 years; or</p> | <p>c. Conclusion of graduate studies, with a minimum of 360 hours, or completion of a master's or higher degree course that is compatible with the activity that the professional will be performing.</p> |
|--|---|---|

*As determined by labor legislation, the Brazilian company shall justify the use of foreign labor and observe the required proportion of 2/3 of Brazilian employees both in relation to the total staff and the corresponding payroll, and the salary offered in Brazil must be higher than the one paid by the company for the same position. This rule suffers criticism on the part of some legal scholars, who consider it unconstitutional due to violating the isonomy principle.*

► **Temporary Technical Work Visa**

*The temporary technical work visa, set forth in Normative Resolution 61/2004, will be granted to foreigners that come to Brazil to provide services to Brazilian companies under no employment relationship and that, for that purpose, are paid abroad based on a Technology Transfer Agreement, Technical Assistance Services Agreement or an agreement for technical cooperation signed between a Brazilian company and a foreign company.*

*In this case, the visa is granted for one year and may be extended for an equal period, provided that there is proof that such extension is needed. This visa cannot be converted into permanent visa. There is also the temporary technical work visa set forth in Normative Resolution 100/2013, which will be granted to foreigners that come to Brazil to provide services to a Brazilian company under no employment relationship. Application for this type of visa is made directly to the Brazilian Consulate abroad and may be granted for a period of ninety (90) days every one hundred and eighty (180) days.*

*For both types of visa, the foreigner must have at least three (3) years of experience in the relevant area and services in the administrative, financial and management areas are excluded.*

► **Permanent Work Visa**

*According to Normative Resolution 62/2004 in conjunction with Normative Resolution 95/2011, the permanent visa will be granted to the employee of a foreign company who is to be transferred to a company of the same Group, based in Brazil, to hold the position of officer, administrator, or member of the Board of Directors of such company, with administration and representation powers, as long as the position is provided for in the company's bylaws or charter documents.*

*A Brazilian company wishing to indicate a foreigner to discharge the duties of administrator must, in addition to the documents evidencing its regularity before the tax, labor and social security authorities, present the following to the Labor Ministry:*

**a)** *Minimum investment: proof of foreign direct investment (in currency, transfer of technology or of other capital goods), by the foreign company that wishes to indicate a foreigner for the position of administrator of the Brazilian company, in the minimum amount of:*

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| <p>1. BRL 600,000.00, for each foreign administrator, by means of a copy of the Consolidated Foreign Direct Investment Statement, obtained directly from SISBACEN (Central Bank of Brazil Information System) following registration of such investment, or of the Foreign Exchange Contract and the respective contractual or bylaw amendment, duly registered at the competent agency, in order to evidence payment of the investment in the recipient company; or</p> | <p>2. BRL 150,000.00 for each foreign administrator, with due regard to the aforesaid documentation, whereas, in this case, evidence shall be produced of the generation of, at least, 10 new jobs, during the two years subsequent to the administrator's entry into the country, observing, in both the aforesaid situations, such proportion of 2/3 of Brazilian employees as set forth in Brazilian labor legislation;</p> |
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**b)** *Salary structure: the present salary of the foreigner appointed to occupy the administrator position in the Brazilian company shall be informed, and also the salary that this person will receive once he or she has taken office. Finally, there must also be indication of whether the foreigner will continue receiving any remuneration from abroad, in addition to receiving a salary in Brazil.*

The type of visa set out in "i", "a" above may be granted for up to five (5) years, depending on the maximum term of office of the management position, as defined in the articles of organization or bylaws of the company. After such period, the visa will be reassessed with the Federal Police, so that the relationship with the Brazilian company that applied for the visa is ended. The type of visa set out in "ii", "a" above may be granted for a maximum period of 2 years, and may be extended.

The possible transfer of the foreigner to another company of the same business group shall be communicated and justified with the Labor Ministry. For a change of job and/or addition of other new functions to those already discharged by the foreigner, the local company shall present justification and an amendment to the contract to the General Immigration Coordination Department of the Labor Ministry.

Concomitant jobs in two or more companies from the same business group must also be authorized by the pertinent authority. Likewise, it is important to mention that for the period during which the permanent visa is linked to the company, any appointment of a foreigner to a position as a non-employee for the same company will be first requested to the Labor Ministry.

The change of employment of the foreigner to another company that does not belong to the business group where the foreigner was discharging his/her duties shall be the subject of prior authorization from the competent authorities. In this case, such authorization must be requested to the Ministry of Justice, and the Labor Ministry will issue its opinion on the subject.

#### ► Permanent Visa for the Foreign Investor – Individual

According to Normative Resolution 118/2015, the permanent visa will be granted to foreign individuals who wish to settle in Brazil by investing their own resources, of foreign origin, in productive activities. In this case, the investor should work as a partner of the Brazilian company, being also authorized (after obtaining the visa) to occupy the position of administrator of that same company.

The requirements for obtaining this type of visa are:

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| <p>A. Evidence of foreign direct investment (in currency, foreign), in the minimum amount equivalent to R\$ 500,000 (five hundred thousand reais), through the presentation of a copy of the Consolidated Foreign Direct Investment Statement, obtained directly at SISBACEN (Central Bank Information System), and the respective contractual or bylaw amendment registered with the competent body, in order to evidence the payment of the investment in the Brazilian recipient company of the investment.</p> | <p>B. Submission of the investment plan that attests the social interest. The granting of permanent visa will be conditional on:</p> | <ol style="list-style-type: none"> <li>1. The verification of the social interest in accordance with the number of jobs generated in Brazil;</li> <li>2. The amount invested and the region of the country where it will be applied;</li> <li>3. The economic sector where the investment will occur.</li> <li>4. Contribution to the increase of productivity.</li> </ol> |
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The General Immigration Coordination Department may authorize the granting of a permanent visa to an individual investor whenever the amount of the investment is lower than the amount set out in the resolution (BRL 500,000.00), provided that such amount is not lower than BRL 150,000.00 (one hundred and fifty thousand) and the company's activities are fully intended for the areas of innovation, basic or applied research, whether or not of a scientific or technological nature.



*The first foreigner's ID card (Cédula de Identidade do Estrangeiro – CEI) will be granted with as 3-year validity term. Upon expiration, a new CEI may be issued by the Federal Police and, at such opportunity, the Federal Police will fix a new expiration date for the CEI, provided that there is evidence of the fulfillment of the Investment Plan and creation of jobs and generation of revenue in Brazil.*

► **Residency Visa Based on the Brazil-Mercosur, Bolivia and Chile Agreement**

*The Mercosur, Bolivia and Chile have agreed that the territory of all such countries constitute a Free Residence Area where their citizens will have the right to work. In this case, no requirement other than nationality will be made. The Free Residence Area was created in the Brasília summit of the Heads of State through the "Residence Agreement for the Nationals of the Mercosur Member States, Bolivia and Chile", signed on December 6, 2002.*

*This Mercosur Residence agreement is now valid for the following countries: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay. The agreement determines that the nationals of all such countries can reside in any of the signatory countries, regardless of their migration condition, and they can work in any position and hold management positions in Brazilian companies.*

*The citizens of such countries, whether native-born or through naturalization (occurred more than 5 years), will follow a simplified process to obtain temporary residency for up to two (2) years in another country of the bloc. The requirements are: valid passport, birth certificate, certificate attesting no history of a criminal record and, depending on the country, medical certificate issued by the immigration department.*

*The conversion of temporary residency into permanent residency is also a simple process and does not require any visa or bureaucracy. After the visa period is lapsed, the only requirement for such conversion is the proof that such individual has sufficient lawful means to support himself and his family.*

# Brazil | LABOR LAW

## LABOR LAW AND SOCIAL SECURITY

The Consolidation of Labor Laws (Consolidação das Leis de Trabalho - CLT) is the main set of rules that regulates labor relations in Brazil. It contains a number of definitions, principles and rules designed to protect the interests of employees and workers in general

## EMPLOYEE

Employee is defined as the natural person who personally provides services to another person, on a habitual basis and under subordination, in exchange for remuneration.

The following criteria must be observed for the hiring of employees in Brazil:

- Minimum age of 16.
- From 14 to 16 only as an apprentice and provided that the employee is studying in the natural sciences area that he or she intends to work.
- Over the age of 18 for night, unhealthy and hazardous work.

## EMPLOYER

Employer is defined as the for-profit or nonprofit entity, with or without a legal personality, that has at least one employee. The employer, in the majority of cases, is a company, but liberal professionals, associations, etc. may also be employers.

## INDIVIDUAL EMPLOYMENT CONTRACT

Individual Employment Contract is defined as the tacit or express agreement, corresponding to the employment relationship. The adoption of a written contract is more advisable.

Contracts may be for an indeterminate or determinate period, though contracts for indeterminate periods are more common, since determinate period contracts are only allowed to be signed in specific situations set forth in law.

## WORK AND SOCIAL SECURITY BOOKLET (CTPS)

The work and social security booklet is obligatory and proves the existence of a written or verbal employment contract.

## REGISTRATION

The employee's registration in cards, books or electronic systems is obligatory.

## RIGHTS OF THE EMPLOYEE

### ► Working Hours of the Employee

*Ordinary working hours are 8 hours a day and 44 hours a week. The law provides for shorter working hours in certain situations (e.g. minors) and for certain professions (e.g.: railroad workers, physicians, telephone operators, journalists, bank workers, etc).*

*The working day will be diurnal, when it is between 5:00 a.m. and 10:00 p.m., in urban centers, with other criteria for rural areas. Nocturnal work generally occurs when the work is performed between 10:00 p.m. of one day and 5:00 a.m. of the following day.*

*Overtime refers to the hours worked beyond the normal limits fixed by law, collective bargaining agreements, normative sentence or individual employment contracts. Overtime is classified into five types:*

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|---|---|--|
| 1. Overtime resulting from an extension agreement, not exceeding 2 hours per day; | 3. Overtime worked for the purpose of the conclusion of non-responsible services or the | 5. Overtime worked to recover work stoppage hours; |
| 2. Compensation of hours system;  | 4. execution of which may cause losses to the employer;                                 | 6. Overtime worked in case of force majeure.       |

### ► Remunerated Weekly Rest Period

*Remunerated weekly rest period is defined as the remunerated weekly rest period of 24 consecutive hours, preferably taken on Sundays and within the limits of the technical requirements of companies, or on public and religious holidays, in accordance with local tradition. The employee's full attendance at work during the week is a condition for the maintenance of the remunerated weekly rest period.*

### ► Meal and Rest Break

*Employees who work eight hours daily are ensured a break for a meal and rest of at least one hour.*

### ► Vacation

*All employees will have the right to vacation, after each 12 month period of a valid employment contract, without prejudice to their compensation. Its duration depends on the diligence of the employee, which is liable to reduction in lieu of the employee's unjustified absences (maximum of 30 and minimum of 12 days' vacation).*

*It is forbidden to discount the employee's absences at work from the vacation period. The employer shall grant vacation during the 12 months subsequent to the acquisition period. Otherwise, the employer must pay double the amount of the vacation pay. During vacation, employees receive the same amount of salary as if they were working, plus a 1/3 bonus. In addition, employees may trade 1/3 of their vacation period in exchange for remuneration.*

### ► Wages

*The law does not define wages, but indicates its components and fixes the rules for its payment and protection.*

*The Government establishes the minimum wage amount annually. On 1 January 2017, it was fixed at R\$ 93700 (approximately US\$ 280).*

*Severance pay, profit sharing, pension plan benefits and their supplements, and intellectual rights are not regarded as wages*

Wages may be paid in cash, check or via bank deposit and in fringe benefits.

The law requires the payment to be made in Brazil's local currency and considers payment in foreign currency as not made, though the latter may serve as the calculation basis for conversion into national currency, at the time of payment.

Payment in fringe benefits or in kind is the payment method whereby the employee receives such economic goods as food, housing, the use of an automobile, credit card, payment of household bills, etc., as payment of part of his or her wage, though it should be pointed out that, according to court decisions and the law, employers are not allowed to pay the entire wage in fringe benefits.

The wage amount may be freely stipulated, provided that such stipulation is not conflicting with the labor protection provisions, collective bargaining agreements and judicial rulings. The following constitute special types of wage:

1. **Advances:** advance in money or wage advance established as a result of temporary needs.
2. **Additional overtime pay:** is at least 50% and is incorporated into the base compensation for the purpose of calculating the additional amounts to which the worker is entitled (13th wage, vacation, etc.).
3. **Additional night pay:** is 20% of the contractual wage due, as a rule, for services rendered after 10:00 p.m., in urban centers, and it is incorporated into the base compensation for the purpose of calculating the additional amounts to which the worker is entitled;
4. **Health hazard allowance:** is due to employees that render service in an environment that is considered unhealthy – it is 10%, 20% or 40% of the minimum wage, according to the degree of health hazard (minimum, average and maximum, respectively) – and it is incorporated into the employee's base compensation for all purposes.
5. **Hazard pay:** is due to employees that render services under highly risky conditions – it is 30% of the contractual wage – and is incorporated into the employee's compensation (except for the purposes of bonuses, gratuities and profit sharing).
6. **Additional transfer pay:** is due to any employee that is temporarily transferred by the employer to another locality and its amount is 25% of the contractual wage.
7. **Others:** commissions, bonuses, gratuities and premium bonuses.

**Thirteenth wage:** Thirteenth wage is defined as a mandatory bonus in compliance with the law and is of a wage nature.

It corresponds to one wage of the employee and must be paid in two installments, the first of which between February and November 30 or at the time of vacation – if the employee so requests in advance, in January of the relevant year – and the second on or before December 20 of each year.

For employees that worked less than 1 year, the 13th wage is proportional to the months of service, in the order of 1/12 per month, considering a fraction of 15 days or over as a full month and disregarding smaller fractions.

#### ► Unemployment Compensation Fund (FGTS)

The FGTS is a bank account that the worker can use on the occasions provided by law, which is formed by monthly deposits made by the employer. Every month, the company has to deposit, with its own resources, in a specific account held by each employee, the equivalent of 8% of the employees' compensation. For employment contracts executed with minors qualified as apprentices, the rate is 2%. The sums deposited will be the property of the employee and withdrawals shall be made in the situations set forth in law, such as in the case of unfair dismissal.

In the latter case, the company is also obligated to pay the employee an indemnity of 40% of the FGTS account balance and pay the sum of 10% of the same balance, as social contribution.

► **Tenure**

*Tenure is defined as the right of an employee to remain in the job, even against the employer's wish, while there is no relevant cause expressed in law and that does not give rise to the employee's discharge, except when there is prove that just cause exists.*

*It is the law that sets forth the cases of job tenure, e.g. the tenure of union leaders and representatives, victims of accidents, committee representatives, expectant mothers and employees' representatives in the CIPA (Internal Commission for the Prevention of Accidents).*

► **Collective Bargaining Agreements**

*In addition to the previously described benefits, companies must observe the rules established in the collective bargaining agreements entered into between the unions that represent the professional category.*

## **TERMINATION OF EMPLOYEES' CONTRACTS**

An employee may be dismissed for cause or without cause. The grounds for dismissal for cause are set out in the law.

Dismissal for cause allows the employer to terminate the employment contract without extra cost (e.g. payment of severance pay, percentage on FGTS deposits, 13th wage and vacation, etc.).

In case of dismissal without cause, the employee will have the right to, among other things, receive ordinary amounts, including: notice period, proportional 13th wage, vacations due, proportional vacations plus the additional 1/3 set forth in the Constitution, 40% of the FGTS deposits and any other amounts as set out in the collective agreement.

The termination of employment contracts with a duration period of more than one year shall be homologated by the Ministry of Labor and Employment (MTE) or by the workers' union of the category to which the employee belongs.

## **FAIR DISMISSAL**

Is based on reasons pertaining to the worker's performance, almost always in an action or inaction relating to breach of discipline. It permits the employer to dismiss without cost (payment of severance pay, or the percentage on FGTS deposits, 13th wage and vacation, the latter two proportional). The law enumerates the circumstances of fair dismissal. The following are inter alia, considered fair reasons for dismissal: improbity, unreasonable conduct, misbehavior, criminal conviction, drunkenness, violation of confidentiality, lack of discipline, insubordination, abandonment of the job, acts that are harmful to honor and reputation, physical offense, constant practice of games of chance.

## **UNFAIR DISMISSAL**

The rule is that of the free dismissal of employees by the employer, in the manner set forth in law, whereby the latter only bears the financial cost, with the exception of the cases of tenure. If dismissed for unfair reasons, the employee will have the right, among other things, to the following amounts: notice (30 days), proportional 13th wage, vacations due, proportional vacations, 40% of the FGTS deposits and withdrawal of the FGTS.

## **HOMOLOGATION**

The termination of employment contracts with a duration period of more than one year shall be homologated by the Labor Ministry or the employees' Union of the category to which he or she belongs.

## **LABOR UNION / TRADE ASSOCIATION LAW**

The core business activity of the company and the number of trade associations existing in its geographical area are what will determine the trade association to which a given company will belong.

The respective employees' labor union will represent all the employees of the company, with the exception of those belonging to officially recognized professional categories, such as secretaries, drivers, economists and journalists, who will be represented by their own particular unions. Both the employees and the companies shall, necessarily, pay the union contributions to the respective labor union/ trade association.

As a rule, negotiations are held annually between the trade association of the company and the labor union of the employees of the same category. The collective labor agreements resulting from these negotiations are filed with the Ministry of Labor and Employment and have force of law.

## **UNION CONTRIBUTION**

Both the employees and the companies shall pay the union contributions: (i) for companies, an annual contribution to the Union of the category. It is based on the number of employees and the registered capital amount; (ii) for each employee, an annual contribution to the union, equal to one day's wage, withheld at source by the employer and paid to the employees' union.

## COLLECTIVE BARGAINING

Negotiations are held annually between the trade association of the company and labor union of the employees of the same category. These negotiations may occur more than once during the year.

Each labor union / trade association conducts its own annual negotiation, which is considered the base date of the respective category.

The collective bargaining agreements resulting from these negotiations are filed at the Labor Court and have the force of law, which means that all employers should respect and enforce all the terms and conditions thereof.

## SOCIAL SECURITY

There is more than one social security regime in Brazil:

- a. The General Social Security Regime: concerning the INSS (Brazilian Social Security Institute) for the private sector.
- b. Specific Social Security Regime: concerning the social security regime that regulates public Federal, State and City government officials and those hired by government agencies and foundations.
- c. Private Social Security Regime: the purpose of this regime is to supplement the pensions from the official social security regime.

The contribution to social security for which the company is responsible, is:

- a. 20% of the total compensation paid, due or credited, for any reason, during the course of the month, to insured employees and free-lancers.
- b. 20% of the total remunerations or compensations paid or credited during the course of the month to the insured individual taxpayer.
- c. 15% of the gross amount of the tax invoice or service bill, with respect to the services rendered thereto by cooperative members (through workers' cooperatives).
- d. 2.6% of the total gross revenue derived from the sale of rural production when involving a corporate entity that has only the rural production activity as its corporate purpose. Some employers are required to pay social security contributions on revenue, pursuant to "Schedule I".

There are also other contributions that must be paid on the total compensations paid or credited to employees, namely:

- a. Contribution for the financing of occupational accidents: consists of the degree that the company provides for the event of incapacity for work resulting from the environmental risks of the work. The percentage of this contribution varies from 1% (low risk) to 3% (high risk).
- b. Third party contribution: are obligatory contributions imposed on the payroll that are earmarked for private social service and professional training entities linked to the union system, whose rates vary from 0.2% to 5.8%;
- c. Education salary contribution: consists of a contribution to the Federal Government (União Federal) for the financing of elementary and middle school (ensino básico). The education salary rate is 2.5%.

The total charges for the company correspond, on average, to 35.8% (the index for industry). These contributions are paid directly to the INSS, which transfers the contributions that do not pertain thereto to the entitled entities.

## OCCUPATIONAL SAFETY AND HYGIENE

As a rule, companies that have more than 20 employees must have an Internal Commission for the Prevention of Accidents (CIPA).

A medical exam is obligatory, both at the time of hiring and upon termination, which shall be at the expense of the employer. In addition, depending on the type of work performed, some employees may be subject to regular and special medical exams from time to time.

Unhealthy activities or operations are those activities that, due to their nature, condition or methods of work, expose workers to agents that are harmful to health, beyond the tolerance limits fixed in the law.

Hazardous activities or dangerous operations are those that, due to their nature or method of work, imply the worker's permanent contact with inflammable products or explosives, under highly risky conditions.

All companies are required to maintain their occupational medicine and safety programs renewed, annually, especially those determined by the Ministry of Labor and Employment (MTE), namely:

- |  |   |
|--|---|
| a. Environmental Risk Prevention Program (Programa de Prevenção de Riscos Ambientais – PPRA).              | c. Technical Report on the Environmental Conditions at the Workplace (Laudo Técnico de Condições Ambientais no Trabalho – LTCAT). |
| b. Occupational Health Medical Control Program (Programa de Controle Médico de Saúde Ocupacional – PCMSO). | d. An occupational health and safety risk assessment (Perfil Profissional Previdenciário – PPP).                                  |

### ► Obligatory Medical Exam

*The medical exam is obligatory, both at the time of admission and termination, at the expense of the employer.*

### ► Insalubrity

*Insalubrious activities or operations are construed as those activities that, due to their nature, condition or methods of work, expose employees to agents that are harmful to health, beyond the tolerance limits fixed in accordance with the nature and intensity of the agent and the time the employee is exposed to such agents.*



► **Hazard**

*Hazardous activities are construed as those activities that, due to their nature or method of work, imply permanent contact with inflammable products or explosives, under highly risky conditions.*

► **Environmental Protection**

*Law 7347/85 stipulates the public civil action for the ascertainment of the liability for damages caused to the environment, the consumer, assets and rights of an artistic, esthetic, historic and tourist value. The Public Prosecution Service ("Ministério Público") has been promoting the protection of the environment and work environment, in cases where there has been a violation of the law.*

## **OUTSOURCING**

Outsourcing is defined as the act of transferring the responsibility for the service from one company to another.

Notwithstanding the absence of specific legislation on the matter, the practice of outsourcing in Brazil is steadily on the rise. Its great attraction is that of transferring the company's non-core activities to third parties.

Companies are adopting outsourcing as a means of cutting costs and enhancing performance in the short and medium term.

Companies that outsource their non-core activities are secondarily liable for the labor and social security obligations of the employees of the company that renders the respective service.

# Brazil | REAL STATE

## OWNERSHIP

**Regulatory laws:** The real right in Brazil, which includes ownership, is regulated by the Civil Code (Law 10.406/2002).

**Real Rights:** Besides ownership, real rights include: the surface area, servitudes, usufruct, the use, habitation, the right of the promising buyer of the property, the pledge, real mortgage and antichresis.

**Establishment and transfer of real rights:** As a general rule, the acquisition of real rights over property, established or transferred by acts between living persons, is only legally carried into effect with the registration of the acts at the Real Estate Registry Office.

**Concept of ownership:** The right to use, enjoy and dispose of a thing, and the right to repossess it from whoever unjustly possesses or holds it. Ownership is presumed full and exclusive, until proved otherwise.

**Exercise of the right of ownership:** Shall be consistent with its economic and social purposes, so that the flora, fauna, natural beauties, ecological balance and historic and artistic patrimony are preserved and the pollution of air and waters are avoided, in conformity with that established in special law.

**Deprivation of the right of ownership:** The owner may be deprived of the property, in the cases of expropriation, public need or interest, or social interest, as well as in the case of imminent public danger which is always subject to just indemnification.

**Ownership of the soil:** Includes the ownership of the corresponding air space and subsoil, at a height and depth that are useful for its exercise. The owner cannot oppose the activities that are performed by third parties at such a height or depth where he does not have a legitimate interest to impede. It does not cover mineral deposits, mines and other mineral resources, potential hydraulic energy, archeological monuments and other property referred to by special laws.

**Fruits:** The fruits and other products of the thing belong, (even when separate), to their owner, except if, by special legal maxim, they belong to another person.

## PURCHASE OF REAL PROPERTY

The most common method of the purchase of real property between living persons is the registration of the title deed at the Real Estate Registry Office. Another

method of acquiring real property is usucaption (prescription): those who, for 15 years, without interruption, or opposition, possess a property as their own acquire its ownership, regardless of title and good faith; and may seek a declaration from the court in this respect which will serve as the title for registration at the Real Estate Registry Office. This period may be reduced in certain cases. It may be reduced to 10 years, for example, if the possessor has established his habitual residence on the property, or carried out works or services of a productive nature thereon. There are other cases of usucaption (prescription) provided in law.

## **MORTGAGE**

Real property may be charged by way of mortgage as security for the debts or obligations of its owner or of third parties. The mortgaged property is subject, by a real relationship, to the performance of the obligation.

The deed granting a mortgage must be registered with the Real Estate Registry Office.

## **RIGHT TO CONSTRUCT**

The owner may erect constructions on his land as he wishes providing he respects the rights of his neighbors and the administrative regulations. The administrative regulations (building rules and zoning restrictions) are mainly set forth in municipal laws. Special attention should be paid to the location and authorization for the establishment of manufacturing plants which are subject to the regulations imposed by the zoning and pollution control agencies.

## **USUFRUCT**

Included in the definition of ownership is the usufruct, which may be on one or more movable or immovable assets on an entire estate or a part thereof, including the fruits and conveniences, in whole or in part.

Assignment of usufruct: the owner may assign the usufruct to another person, continuing with the tenancy.

Establishment of usufruct: the usufruct of real property, when not resulting from usucaption (prescription), will be achieved by registration in the Real Estate Registry Office. Unless otherwise provided, the usufruct is extended to the fixtures of the thing and its extensions. The usufructuary has the right to the possession, use, administration and receipt of the fruits.

Methods of exercising usufruct: the usufructuary may usufruct in person, or by means of leasing the building, but cannot change its economic use, without the

express authorization of the owner. The usufructuary is not obliged to pay for dillapidations resulting from the regular exercise of the usufruct.

Extinguishment of the usufruct: the usufruct is extinguished, and the registration at the Real Estate Registry Office cancelled, upon inter alia the occurrence of the following events: the waiver or death of the usufructuary; termination of its duration period, extinguishment of the corporate entity in favor of whoever the usufruct was established, destruction of the thing.

## CITY LEASING

Regulatory laws: the leasing of city real estate, which includes both residential property, and non residential or commercial property, is, as a general rule, regulated by Law 8245/91. There are exceptions, regulated by the Civil Code and special laws.

Term: the lease contract may be adjusted for any length of time. During the stipulated term the landlord may not repossess the leased property. However, the tenant may do so, provided he pays the fine stipulated in the contract, or if there is none, the judicially stipulated fine. However, the tenant will be exempt from a fine, if the return of the property results from the transfer by its private or public employer to render services in different localities to the one at the start of the contract.

Sale of leased property: if the property is sold during the lease, the purchaser may cancel the contract giving the tenant ninety days to vacate the premises, save if the lease is for a specified term and the contract contains a continuity clause in the case of a sale and is registered in the Real Estate Registry Office. Termination of lease: the lease may also be annulled by mutual agreement.

Assignment of lease: the assignment of a lease, sublease and loan of the premises, either totally or partially, depends on the prior written consent of the landlord.

Rent: the parties are free to adjust the rent, though its stipulation in foreign currency and its tying to a foreign currency or the minimum wage are prohibited.

Pre-emption rights: in the case of a sale, the promise of sale, assignment or promise of assignment of the rights or *datio en solutum*, the tenant has preference to purchase the leased property, on equal conditions to that of third parties. The landlord shall notify the tenant of the transaction by means of judicial or extrajudicial notification or other equivalent means.

Repossession in residential leases: Besides the general cases of the termination of the lease contract mentioned above, the law provides two types of repossession exclusively for residential leases. These depend on the initial term of the lease: a) in leases recorded in writing, for a term corresponding to or in excess of 30 months, the termination of the contract will occur at the end of the stipulated term, regardless of notification or notice. If the tenant continues in possession of the leased

premises for more than 30 days without objection from the landlord, the lease will be presumed to be extended for an indeterminate period of time and the terms of the lease will continue. If the extension occurs, the landlord may cancel the contract at any time, specifying a period of 30 days to vacate the property (eviction or landlord's repossession of the premises without stating the reasons); b) in leases agreed verbally or in writing with a term of less than 30 months, at the end of the established term, the lease is automatically renewed for an indeterminate period of time, and the premises may only be repossessed in cases explicitly stated in law. (with cause).

Right to renewal in the leasing of premises for commerce: in order to protect "goodwill", the law grants the tenant the right to the renewal of the contract, for an equal period, regardless of the landlord's consent, provided that the following requirements are cumulatively met: (i) the contract to be renewed has been executed in writing and for a specific term; (ii) the minimum term of the contract to be renewed or the sum of the uninterrupted terms of written contracts is 5 years; (iii) the tenant is exploiting its commerce, in the same field, for the minimum and uninterrupted period of 3 years.

#### **COMMODATUM**

A property may also be granted under a commodatum, which is the gratuitous loan of fungible things. If the commodatum does not have a conventional term, the necessary time for its permissive use will be presumed. The lessor of a commodatum, save an unforeseen and urgent need, acknowledged by a judge, may not suspend the use and enjoyment of the property loaned, prior to the end of the stipulated term, or the term determined by the use granted.

The lessee is obliged to maintain the property loaned as if it were his own, and may not use it other than in accordance with the agreement or the nature thereof, save that he is liable for loss and damage. The lessee, besides being accountable for the loaned property, must also pay the rent of the property, until its return.

The lessee is not entitled to recover any expenses incurred in connection with the use or enjoyment of the thing loaned from the lessor.

#### **PURCHASE OF PROPERTY BY FOREIGNERS**

The purchase of city properties can be freely made: (i) by foreign individuals and corporate entities residing or domiciled abroad, where the investment made in the purchase of the property is not subject to registration with (BACEN); (ii) by a corporate entity based in Brazil, but controlled by foreign capital, where the investment made in the purchase of the property is subject to registration at BACEN, as foreign capital invested in a Brazilian company.

Rural real property is subject to the following basic rules: a) the sum of the rural property owned by foreigners cannot exceed 1/4 of the surface area of the Municipalities and persons of the same nationality may not own more than 40% of this limit; b) the surface areas are divided into modules, whose areas, in accordance with the locality, range from 5 ha. (Greater São Paulo region) to 100 ha. (according to the region of the country); c) foreign individuals residing in Brazil may freely purchase areas of up to 3 module units for undefined exploitation, provided that the aforesaid surface area restrictions are observed and it is the foreign individual's first purchase (in practice, it is recommended that INCRA (National Land Development Agency), associated to the Ministry of Land Development, be consulted beforehand to check that the acquisition is within the surface area limit). For areas in excess of 3 and up to 50 module units, and for the second purchase operation, authorization from INCRA must be obtained, whereas for areas of between 20 and 50 module units, a land use proposal will also have to be submitted. For areas of 50 to 100 module units, approval will be necessary from the President of the Republic, together with evidence to the effect that the project is of national interest and approved by the National Defense Council. For the purchase of areas in excess of 100 module units, authorization from Congress will have to be obtained; d) foreign corporate entities authorized to operate in Brazil, or corporate entities based in Brazil controlled by individuals or corporate entities residing or based abroad, shall obtain authorization from the Ministry of Land Development, through the competent agency, in this case, INCRA; (e) foreign individuals that have Brazilian children or are married, under the partial or community property system, to a Brazilian, are free to purchase rural property.

Although the restrictions on the purchase of rural property listed in item "d" above are in theory, in force, a new understanding established by the Ministry of Land Development, with the Attorney General's Office of INCRA in Brasília, has now eased the purchase and leasing of rural properties by companies domiciled in Brazil and controlled by foreign capital.

Nevertheless, special restrictions are made for rural properties located in frontier strips, construed as the area indispensable to national security. This area is defined as the 150 kilometer (equivalent to 93 miles) wide internal strip, running parallel to the borderline of the Brazilian territory.

The purchase of rural real property within the frontier strip by a foreign individual or corporate entity, or by a company with any foreign ownership interest (whether majority or minority, as a stockholder or member of the Administration), will depend on the prior approval of the National Defense Council.

Prior approval from the National Defense Council is also required for the establishment or operation, in the frontier strip, of industries that are of interest to national security, as listed in the decree of the Public Power, and the establishment, in this same strip of companies.

# Bazlyankov, Stanoev & Tashev Law Offices

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Bulgaria

## General Information

Bazlyankov, Stanoev and Tashev Law Office was founded in 1991 in the town of Plovdiv by the lawyers Nikolay Bazlyankov and Dessislav Tashev. In 1997 Boyan Stanoev joined as a full partner and in 2009 lawyers Ekaterina Nikolova and Diana Ilieva became partners in the law office as well.

Today BST law office is one of the biggest and most dynamically developing law firms in Bulgaria.

BST law office has established traditions in the Bulgarian legal environment and offers the full spectrum of legal services in various fields.

We have achieved success and prestige due to our professionalism and the enterprise of our ambitious team of lawyers, also due to our exceptionally correct relations with clients, our sticking to commitments, our individual approach in accordance with the specifics of each case, and our ambition to achieve a successful solution and finalization. We provide full support in clients dealing with different administrative structures and we cooperate and help during the conducting of negotiations in favour of the client.

The process of our own development and improvement is an uninterrupted and dynamic one, with skillful researching, acquiring and implementing of traditional and non-traditional methods and original ideas and solutions in the process of the work, as well as

constant striving for and interest in the adoption of current innovations not only in the areas of law, but in other fields too.

Bazlyankov, Stanoev & Tashev law office is specialized in ensuring reliable and good quality representation of its clients before courts of justice, state and municipal authorities in the entire country.

Legal consultations are provided for Bulgarian and foreign natural and legal persons, for branches and representatives of foreign companies in Bulgaria, for public entities and nonprofit legal persons.

The law office is a member of the Association of European Lawyers - AEL, of the International Association of Law Firms - E-iure and of the Global Network of Independent Law Firms - ALFA International.

The BST Law Office provides services in English, Spanish, Italian and Russian languages.

## Areas of Practice

**Commercial Law:** Incorporation and registration of companies, structuring of holding groups, share transfers, bankruptcy and liquidation; **Contractual law:** all kinds of Agreements, contracts under general conditions, public procurement; **Real estate and investments:** real estate deals, consultations on investments in real estate, construction - requirements and procedures, notary

proceedings, pledges and mortgages, legal analyses and research; **Privatization:** privatization deals, structuring of privatization projects, negotiations with state authorities; **Tax Law:** tax consultations, representation before the tax authorities, Avoidance of double taxation treaties; **Competition law:** concentration of industrial activity, unfair competition, representation before the competition protection committee; **Intellectual property law:** representation before the patent authority of the republic of bulgaria, procedures and registration of trademarks and service brands (designations of origin and geographic designations), drafting of copyright contracts and litigation with regards to copyright disputes, overall protection and advice on intellectual property; **Law of employment and insurance:** employment contracts, conclusion (amendment and termination), collective employment contracts, consultations in relation to the hiring of Bulgarian and foreign staff, labour disputes; **Civil procedure law:** preliminary assessment of legal disputes and preparation of suits, mediation (solving disputes outside of court), litigation before public courts of justice, arbitration agreements and procedures; **Administrative procedure law:** challenging of administrative acts, normative requirements and rules of trade and consumer protection, consultations about regulation requirements in Bulgaria.

📍 16, Altzeko Str. 2nd floor  
Plovdiv 4000, Bulgaria

☎ + 359 32 266 620  
+ 359 32 634 078  
+ 359 32 653 189  
+ 359 32 620 503  
GSM: + 359 888 857 552

📠 + 359 32 653 164

plovdiv@bstlawyers.com

www.bstlawyers.com

## The Team

BST law office has a team of lawyers, trainees, accountants, experts and administrators working. They are all exceptional professionals, each in his/her field, and they are dynamic and active people, too. Our conduct, principles and relations are based on solidarity, developed skills for teamwork, as well as team spirit.

The initiative which we all support is to lead our clients to success and optimal and positive results. This is why we try to use an accessible and understandable way of communication to our clients, to give adequate advice and offer solutions in accordance with the case and the personality of each individual. We lend our experience and knowledge and we guarantee responsibly and without reservations our commitment to the clients and their cases. We strive to make a positive impression of safety with our conduct and style of work.

### Senior Partners

Nikolay Bazlyankov  
Boyan Stanoev  
Ekaterina Nikolova  
Diana Ilieva

### Trainees

Hristina Kalcheva  
Maya Ruseva  
Siyana Dylgerova  
Yoana Dimitrova  
Simona Laneva

### Attorney at Law

Videlina Kurshumova  
Katerina Hristova  
Nedka Onova  
Ivelina Pacheva  
Stiliyana Petrova  
Boryana Dimitrova  
Irina Daradzanska  
Katerina Lyutakova

### Accountants

Rumen Lyaskov  
Petrunka Atanasova  
Anelia Spaski  
Lilia Tabakova



# Bulgaria | CORPORATE LAW

## • Regulations and Rules

Bulgarian corporate law is codified and integrated into the Commerce Act. This act contains most of the rules of company law – incorporation of the companies, rules regarding the decision-making bodies, changes in the capital /increasing or decreasing/, insolvency and liquidation, merges and acquisitions of companies.

It is to be also noted that the resolutions of the EU in the area of corporate law are in force in Bulgaria, as its member state, as well as several commercial directives, that are implemented in the corporate legislation of Bulgaria.

## • Types of Companies

In Bulgaria there are different legal forms to develop business. The most frequently preferred types by Bulgarian and foreign investors are:

### ▶ **Limited Liability Company /LTD/**

*Is a small and the most commonly incorporated company in Bulgaria. A company with minimum capital of 2 BGN /1 euro/. The partners can be Bulgarian legal or natural entities, as well as foreign legal or natural entities. This is a very adequate form for small or average businesses, where not only capital, but personal relations between the partners play their vital part. The law has seen to this specific of the entity by setting the consent of the other partners as a requirement for exception of a new member into the company. As a comparison, such a requirement does not exist for gaining the capacity of a shareholder in a JSC.*

### ▶ **Single - Member Limited Liability Company**

*A single partner /a Bulgarian legal or natural entity, as well as foreign legal or natural entity/ possesses the whole share capital of the company, the minimum capital is 2 BGN /1 euro/.*

### ▶ **Joint Stock Company /JSC/**

*Company with a minimum capital of 50 000 BGN /around 25 000 euro/ of which at least 25 % must have been paid at the time of incorporation. The capital is divided into shares. This form is*

*preferred by the average and major enterprises, where the most valuable asset a shareholder can bring is capital. It should be highscored that the decisions for increase or reduce of the capital are made with the majority of 2/3 of the shareholders, presented at the General meeting, where the other vastly used form of entity – LLC, requires unanimity for such an action. Therefore JSC allows for faster and easier accumulation of funds, which management and control are secured by other detailed provisions of the Commerce Act.*

► **Single - Shareholder Joint Stock Company**

*There is only one shareholder who possesses the whole share capital, divided into shares.*

All these companies are limited liability companies:

- a. General Partnership – is incorporated by two or more general partners who are unlimitedly liable.
- b. Limited Partnership – is incorporated by two or more partners, some of the partners are limited liable to the amount of capital contributed and other partners are unlimitedly liable.

## THE INCORPORATION OF A BRANCH

A company, duly registered in Bulgarian Registry Agency, Commercial register can open a branch or branches in a town, different from the company's registered office. The incorporation of a branch requires a formal resolution, taken by the decision-making body, authorising the establishment of a branch and appointing a representative. The branch does not have a legal personality and represents an economic structure, which is managed separately than the company but cannot have a separate balance. It is inscribed in the Commercial register and information about this separate registration should be present in the branch's correspondence.

## THE BRANCH OF A FOREIGN COMPANY

The regulation regarding a branch of a foreign company in Bulgaria is provided in the Commerce Act. A foreign company duly registered under the national law of the respective country can open a branch in Bulgaria. For this purpose, the Commercial Register requires submission of the documents for the registration of the Company and the decision making body has to take a decision about the address of administration, representative, activity of the branch. It is provided that the branch has separate balance and should have, respectively reflecting on the tax issues – the branch of a foreign company is a different tax subject.

## • The Liability of Shareholders

In all of the limited liability companies /Ltd and JSC/ partners' / shareholders' liability is limited to the capital contribution. If a partner/shareholder participates actively in the management of the company in the capacity of manager/ director, the one becomes liable for corporate wrong management in the event of bankruptcy, but only due to the latter stated capacity.

The shareholders are not liable for the Company's debts as the company and its shareholders are considered for company law purposes as separate legal persons.

## • Share Capital (minimum and minimum paid in amount)

Company	Minimum (€)	Minimum paid in amount
Limited Liability Company / LTD /	1	70%, but not less than 1 €
Single Limited Liability Company	1	70%, but not less than 1 €
Joint Stock Company / JSC /	25.000	25%
Single Shareholder JSC	25.000	25%

## • Shares and Share Rights

The JSC and the Single JSC issues shares, which may be registered and bearer, ordinary or preference. It is common for companies to issue only one class of shares, known as ordinary shares. The rights and restrictions attaching to the shares are listed in the articles of association of the Company. The shareholders, who hold preference shares would carry additional rights /for example - to receive extra dividends/. It is accepted for the shares to be freely transferable. However, the article of association is the act that provides the restrictions on the transferring of shares and the way of transfer. When shares are issued or transferred, details of the shareholder are registered in the company's statutory books and a share certificate is issued.

## • Corporate Governance

### SHAREHOLDERS MEETING

#### ► Partners/ Shareholders Reserve the Right to Make Certain Decisions

*Bulgarian Commerce Act distinguishes ordinary and extraordinary resolutions. As for the ordinary resolutions, the required majority is more than 1/2 and for the extraordinary resolutions the required majority is higher, such as more than 2/3 or 3/4.*

**a. Ordinary resolutions are:**

approval of the annual report and the balance sheet, appointing the manager, adoption of resolutions for opening and closing of branch offices and for participation in other companies or adoption of resolutions for acquisition and expropriation of real estates and real rights.

**b. Extraordinary resolutions are:**

making amendments and supplements to the Articles of incorporation, admittance and dismissal of a partner in LLC, transfer of part of the company to a new member in LLC and adoption of a decision on additional monetary contributions in LLC.

*As it was mentioned, the resolutions for reduction and increase of capital in LLC are adopted unanimously by all partners, and in JSC they are taken with the majority of 2/3 of the presented capital.*

*It is worth highlighting that due to an amendment in the Commerce Act in 2016 some decisions, adopted by the partners in LLC, require a record with simultaneous notarisation of the signatures and contents thereof. Those decisions regard the admission of partners, changes in the capital, appointment of the managing director and acquisitions and transfers of property rights. However, the notarization is not required in the case, where the Memorandum of Association provides for a simple written form of those decisions. Consequently, the current regulation of the LLC gives the partners the choice to stick to the traditional unconditioned way of doing business, to make their LLC a simplified, yet very protested structure, or to create something in between.*

**a. Minimum number of broad meetings/year:** once a year, at least one shareholders' meeting must be held each year in order to approve the accounts of the previous year. Both JSC and Single JSC must have a Statutory Auditor. The Board of Directors annually after the end of February composes for the previous year an annual financial statement and report for the Company's activity and presents them to the expert accountants-auditor appointed by the shareholders for examination and report.

### MANAGEMENT

The General meeting of partners of a LLC made the most important decisions concerning the capital, the structure, management of the company, the admittance and expelling of shareholders, the acquisition and disposing of real estates, etc.

The ruling bodies of a JSC are the General meetings of shareholders to decide the most important issues. The other bodies depend on the system of management,

which has been chosen. As there are usually a greater number of shareholders the law does not require unanimity for any decisions made by the General meeting. The General meeting is not entitled to make decision for acquisition or disposing of real estates as this issue is in the scope of the Board of directors' powers.

**a. The one-level system** includes only a Board of directors consisting of 3- 9 members, which is the ruling and representative body of the company. The board chooses one of its members who, in his capacity of an executive director, solely represents the company and performs the basic actions, connected with the management but on the grounds of a relevant decision of the Board.

**b. The two-level system** of management includes a Managing Board and a Supervisory Board, which requires a well experienced method of cooperation between the two boards as some of the actions should be performed by the Managing Board with the consent of the Supervisory Board which chooses the members of the Managing Board and controls them permanently. The first system is widely used because of its larger flexibility and simplicity than the two-level system.

## MANAGER AND EXECUTIVE DIRECTOR

In the article of association of the company is provided which company body has the rights to appoint or dismiss a manager/executive director of his duties. The person, who is to act as a manager/ executive director, must sign a declaration - consent and provide specified information to the Commercial Register. A management contract can be concluded by and between the Company and the manager/ executive director and shall stipulated his duties, remuneration and liability.

The General Meeting of the partners of LLC appoints and sets a manager of the company and his remuneration. It is not necessary for the manager to be a partner. The owners of the share capital have the opportunity to appoint as a manager a person, who represents the company and binds it in its relations with third parties. The manager carries out the current management of the company and concludes agreements on behalf of the company.

The executive directors in a JSC are appointed by resolution of the members of the Board of Directors and the Board determines their remunerations. There are no specific rules on the level of remuneration and it will usually be a matter of negotiations.

The managers or the executive directors have to act in the Company's interests and with the care of a prudent businessman, as well as not to accomplish personal gains on behalf of neglecting their aforesaid duties. The representative shall organize and manage the Company's activities in compliance with the law and the resolutions of the General Meeting/ Board of Directors. The manager/ executive director has the rights to convene the General Meeting, pursuant to Bulgarian legislation and the Article of association.

► **Minutes /filing with the registry of commerce and companies**

*Minutes must be kept in a Minutes Book. They are signed by the Manager of a LLC and the executive director of the JSC and by the partners/ shareholders who are present at the General meeting. Only an authorized by the Board of Directors person can write the relevant information in the books.*

*In case of amendments and supplements to the Article of incorporation, changes concerning the capital, the structure and the management of the companies must notify the Commercial Register and an announcement for the convening of the General Meeting shall be done in the Commercial register.*

**THE COMMERCIAL REGISTER AND REGISTER OF NON-PROFIT LEGAL PERSONS ACT**

The new Commercial Register Act was adopted and approved by Bulgarian Parliament in 2006 and came in force on 01.01.2008. Parliamentary approval of the act fulfils a recommendation in the European Commission's Monitoring Report on Bulgaria of October 2005 to introduce electronic access to the commercial register and the requirements of Directive 2003/58 of the European Parliament and the European Council. Now the Commercial Register Act has been supplemented and as of 01.01.2018, it is to include the regulations of the Register of Non-Profit Legal Persons, where electronic access is introduced, as well.

The enforcement of the Commercial Register Act created a central electronic register and enabled cheaper and faster registration, simplified and secured procedures, accessible through Internet. This implementation is in full synchrony with the activities on European level and a direct link to the Bulgarian Commercial register can be found on the internet site of the EU Commission.

The Bulgarian Registry Agency is the state agency that facilitates the procedures, regarding the incorporation and changes in the companies and ensures more transparency for the partners, shareholders of the companies and the connections between natural and legal persons. The applications, regarding the companies are reviewed very fast which considerably helps the various business activities. If the administrator finds that the legal requirements are not met, he/she has to draw up a motivated refusal. The refusal can be claimed to the District court upon the location of the Company.

An indisputable asset of the act is the provision to introduce a standard centralized electronic registration system for companies and the direct and easy access to the company information.

The provisions of the Act are currently applied in practice with ups and downs as some issues, regarding the Commercial register shall be clarified and solved /such as different requirements of each administrator, especially with regards to any new provisions in the Commerce Act/.

The Commercial register Act provides that till 31.12.2011 is the deadline for free of charge re-registration of the existing companies in the Commercial register. Sole traders and branches of foreign traders in respect whereof no re-registration was requested within the time limit, are considered deregistered as of 1 January 2012. However, the companies and cooperatives which did not re-register in the Commercial register were not immediately deregistered. Those were wound up on 01.01.2012 and were forbidden to pursue business as of that date. Their company was to enter a procedure for liquidation, which is provisioned to start on request of an interested party. The law states that the deadline for such a request is 31.12.2015, the liquidation must be completed until 31.01.2017 and as of the latter date those companies are deemed deregistered.

However, the law also provides that where a property is found in respect of a deregistered trader, an application for liquidation may furthermore be submitted after the aforesaid time limit, but not later than 31.12.2022.

Consequently, even though the legislation sets a specific term for filing a request for liquidation and that term expired on the 31.12.2015, many district courts have had the chance to rule that a liquidation is still possible for a deregistered company until 31.12.2022, provided a property is found, and therefore the judges have protected the rights and interests of creditors and shareholders once more.

- **General notes**

In response to the development of market attitudes Bulgaria carried out a number of changes within the last decades in its legislation, including tax legislation. During that period major reforms have been put in place, which regulate the tax liabilities of economic subjects/local and foreign/ for their operation on the territory of Republic of Bulgaria. Now it is possible to say that Bulgarian tax legislation is in compliance with the legislation of the European Union.

- **Significant Developments**

The tax regulations of the European Union are applicable in Bulgaria and the intercommunity rules are implemented in the Bulgarian legislation.

- **Tax on Corporate Income**

Corporate profits are levied at 10% rate. The profits, received from sale of shares and other financial instruments are not levied with tax, but only in case if the shares and the financial instruments are registered on Bulgarian Stock Exchange.

- **Corporate Residents and Objects**

The Corporate Income tax Act taxes profits of Bulgarian and foreign legal entities, which have been generated on Bulgarian territory, through a place of business or permanent establishment. This law also regulates the taxation of income of foreign legal entities and individuals such as: dividends, interests, royalties.

The maximum tax rate on these sources of income is 10%. Where there is a double tax treaty between Bulgaria and the country of origin of the foreign company/ individual/, the treaty rates are applicable.



- **Other Taxes:** VAT- Transfer tax- Stamp duty- Property Tax.

- a. VAT rate on the business turnover is 20 %. Generally all supplies are taxable with the exception of explicitly designated supplies such as: medicine, medical services, social services, financial services.
- b. Transfer tax /local municipal tax payable upon transfer of ownership over real estate/. In Bulgaria this tax is applied only on transfers of real estates and vehicles. From the 2011 its rate is between 0.1 – 4.5 % of the price of the real estate included in the deed. The exact percentage is determined with a decision of the Municipal council in every municipality.
- c. Stamp duty is paid to the Registry Agency upon the transfer of ownership over a real estate: its rate is 0.1 % of the price of the real estate included in the deed.
- d. Annual Municipality Property tax: This tax is levied on the property of individuals and businesses. Taxable properties are only real estates and vehicles. The tax rate depends on the value of the property, its location and type.

- **Branch Income**

Profits realized by foreign branches in Bulgaria are generally subject to taxation at a 10% rate which is withheld at their Bulgarian source. The income generated through a branch in a foreign territory, are considered as a part of the incomes of the head office. In this case if there is not a double tax treaty legal entities apply tax credit for each identical or similar tax paid in foreign territory.

- **Income Determination**

Inventory is valued in compliance with the accounting policy of the companies, worked out on the basis of IAC and IFRS. Applicable Standards give companies the opportunity to adjust the value of the inventory with the market prices, but for the tax purposes, the effect of these transactions on the net operating profit is eliminated.

- a. Capital gains: Gains from transfer of shares and participations are part of the operating profit of the companies.
- b. Intercompany domestic: Dividends, arising from shares or participations in Bulgarian companies and accruing to foreign companies, which do not participate in the capital through their place of business in Bulgaria, and natural persons (local or foreign) are taxed at a 5% rate. Dividends, accruing to companies, which are local residents of countries of the EU, are treated as such, accruing to local companies, and are not taxed. The capitalized part of distribution of dividends is exempted from taxation.
- c. Foreign income: As mentioned above, foreign income is considered part of the income of the local entity. Two ways of taxation are possible – application of rules of a double tax treaty /if there is such/ or of the right to a tax credit paid for identical or similar taxes in the foreign country.

- d. Deductions: Necessarily entailed expenditures for the operation of the company are generally deductible, with some exceptions. These are expenses for gifts and entertainment and some social benefits, received from the employees on the account of the employer, as well as the costs for the personal use by the employees of any assets, made available by the employer, including the expenses on cars, used for personal needs. These expenses are deductible, but they are subject to a withholding tax at a 10 % rate. The tax paid is recognized as an expense for operation of the company.
- e. Depreciation and depletion: According to the applicable accounting standards, each company can choose a method of depreciation. But for the purposes of taxation the sum of depreciation is limited to the tax deductible depreciation rates for each group of assets. Commercial, industrial and administrative buildings facilities 4%; Machinery, equipment and apparatus 30%; Vehicles, without automobiles; coverage of roads and airplane runways 10%; Computers, peripherals for them, software and the right to use software, mobile phones 50%; Automobiles 25%  
\* Fixed assets with limited by contract or law term of use – 100/limited years of use Any other type of assets 15%
- f. Net operating losses: According to the legal provisions net losses can be carried forward for five years.

- **Group taxation:** There is no special tax regime for holding groups.

- **Tax incentives**

Taking into consideration the low tax rate in Bulgaria, tax incentives are not such an important factor. In spite of this, there are some tax allowances for manufacturing companies.

- **Tax administration**

Returns: By March 31 of each year, companies are obliged to file a tax return, accompanied by a balance sheet and some other statements for the results of its operation for the previous year. As of the same date the balance of the annual tax liability has to be paid, too. Advance payments are required. Their size is calculated at the basis of the profit from the previous year and divided into 12 monthly installments. For a new company or a company that ended the previous accounting year with losses, the advance payments are quarterly on the base of actual results.

- **Withholding taxes on dividends, interest and royalties**

Non treaty rate 10 %

Bulgaria has signed and is a party to a number of Double Tax Treaties and Double avoidance tax agreement dealing with the withholding taxes.

## INDIVIDUAL TAXES

1. General note. The maximum individual tax rate from 01.01.20017 is 10%.
  2. All residents, who generate revenue in the territory of Bulgaria, are obliged to pay tax. Bulgarian residents are taxed on their worldwide income. Sources of individual income can be labour agreements, rendering services/ lawyers, architects, etc./, or economic activities like agriculture, capital gains and others.
  3. For 2017 employees have to contribute 10,14 % of their gross salary to fund social security and 3.2 % to fund health benefits. All of these are deductible from the gross income to form the taxable base. The rates are changed in the beginning of every year.
  4. Capital gains tax is levied at the source and the tax is final. This income is not included in the taxable base of the individual.
  5. Personal allowances: allowances are available only for people with children up to the age of 18.
  6. Tax credit is possible only for Bulgarian residents for their foreign income.
- Transactions:** all transactions of a total amount exceeding BGN 10,000 are transferred via bank account, no cash payments are permitted for amount higher than this.

# Bulgaria | FOREIGN INVESTMENT

The complete freedom of foreign investments in Bulgaria is an established general rule in the Bulgarian legislation. Going back to the past two decades and further, Bulgarian authorities have encouraged the foreign direct investments by government incentives and maintaining low corporate tax, which has held the flat rate of 10% for the last 10 years. The cheap labour has also been a vital factor that has attracted plenty of companies in the business outsourcing sector, and combined with the wide variety of natural resources, it makes Bulgaria a chosen destination for many investors in environmental, agriculture and other areas. Least, but not last, the acceptance of Bulgaria in the European Union in 2007 not only led to some legal and administrative alleviation for the investors that came from the implementation of the EU's legal achievements in the area, but foreign investor can also rely on the fact that REGULATION (EU) No 651/2014 for declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, is in full force in Bulgaria.

## • Provided incentives for the investors and required certifications

Investment Encouragement Act provides regulations about the investing in Bulgaria. The law does not restrict the foreign investment process, although the activities are subject to prior certification. The regulation of the foreign investment projects provides serious encouragement and alleviation for the investing, such as: administrative servicing in shortened terms and individual administrative services; sale of private state or municipal property, as well as sale of public property, without auction or competition at market or lower prices; financial support for construction of elements of the technical infrastructure; financial support for partial reimbursement of the obligatory social security contributions, tax reliefs and others.

Investments must meet different criteria in order to obtain a certificate and to benefit from the encouragements, granted by the state. Those criteria are related to the minimal amount of investments, made by the company, and the work places that shall be opened by it. For municipalities with high unemployment rates the requirements can drop down to opening 10 new work places. The highest requirements are set for the so – called Priority investment projects, which in the general case involve investments of 100 million BGN (approximately 50 million euro) and 200 work places.

It is worth highlighting that the Investment Encouragement Act explicitly states that amendments to the legislation that set statutory restrictions on foreign investment do not apply to investment, which were made prior to the amendments,

and therefore in that case the legal provisions that were in place at the time of the investment shall continue to be applied.

- **Transfer of dividends, interests and royalties abroad**

According to the Bulgarian legislation there are no restriction for the transfer of dividends, interest and royalties abroad.

Bilateral tax treaties and double avoidance tax agreements provide withholding of taxes.

- **Repatriation procedures and restrictions.**

Bulgarian legislation does not apply any repatriation procedures or restrictions.

- **Foreign personnel (permits, etc.)**

EU citizens can be employed in Bulgaria without the need of prior authorization. On the other hand, hiring any other foreign personnel requires residency permits, which can be issued if the employee satisfies exhaustive number of criterias. Bulgarian law does not encourage hiring foreign non – EU citizens in areas with sufficient Bulgarian work staff.

# Bulgaria | LABOUR LAW

Bulgarian labour law and the decisions of the Bulgarian labour courts regulate the employment mainly in favour of the employees. The relationships between the employees and employer and their obligations and rights are systematized and regulated in the Labour Code.

The access to the labour courts in Bulgaria is free and the employees are not required to pay any court fees. The employees frequently claim damages, obtained by wrongful dismissal.

## • Employment contracts

### CLASSES

The main classes of contracts are:

**a. fixed terms contract and**

**b. contracts with indefinite duration.**

These types of contracts can be concluded for part time and full time jobs.

### COST OF DISMISSAL AND WRONGFUL DISMISSAL.

The Labour Code regulates the reasons for employee's dismissal. The reasons can be non-execution of duties, gross misconduct or breach of the disciplinary rules in the company. If the dismissal is not based on one of the reasons, pointed in the Labour code, the employee is entitled to claim for damages. In some cases the employer can terminate a labour contract without prior notification. But most employment agreements stipulate a prior notice period, which period varies /from a month to three months/.

In certain situations, where the employee has no fault for the termination of the contract, the law stipulates that the employer must pay an indemnity for the dismissal. The legal minimum of the indemnities is equal to the fourfold monthly gross salary, but the work contracts may provide for more favorable indemnities.

In addition to the payment of indemnity, if the dismissal is judged illegitimate, the employee is entitled to compensation from the employer, amounting to the worker's gross labour remuneration for the period of unemployment caused by reason

of the said dismissal, but not more than six months. The period of unemployment has to be proofed by the employee by providing a proving a work book with no further records of employment or certifying document, issued by the Bureau of employment. However, if the Bureau of employment offered adequate work to the employee and he/she did not take it, the aforesaid compensation would not be ruled in favor of the employee.

### **EMPLOYMENT CONTRACTS FOR DIRECTORS; A SPECIAL REGIME**

Directors and managers can be appointed by the General meeting of the partners of Limited Liable Company or the Board of directors of Joint Stock Company. Their work contracts are concluded prior to their appointment. According to the Bulgarian commercial law this type of contracts are called contract for management. Their duties are defined in the article of incorporation of the company and the employer supervises their work process. The manager/director receives special remuneration for their specific duties.

If the manager/ director has other work contract it may be suspended for the period of their management. After the termination of their appointment as a manager/director, the employment contract begins to operate again.

Bulgarian commercial law regulates the special regime of the procurator. The General meeting or the Board of Directors appoints a procurator – special representative and manager of the company, who acts alongside the manager/ director.

## **• Employees’ Representatives and Union Representation**

### **BRIEF SUMMARY OF THE INFLUENCE OF THESE GROUPS IN LABOUR CONTRACTS**

On a national level, the employees’ representatives, the trade unions and employers’ representatives, negotiate the provisions of new laws and the conditions of the Collective Bargaining Agreements.

In a company trade unions and employees’ representatives are the connection between employers and employees. Bulgarian labour law determines the certain obligations of the employers, such as providing employees’ representatives with information, concerning the economic condition of the company, state of employment in the company, implementation of new technologies, and development of the working conditions of employees.

The employees' representatives must be consulted and announced in advance for the future dismissals of employees and changes in the structure of the company, which may have influence on the work process. The employees' representatives may have the right to give a statement for the dismissal of some persons with equal qualifications.

### WHEN DOES A LABOUR UNION REPRESENTATION BECOME BINDING?

The employees and the labour representatives can organize the elections of employees' delegates, who discuss the employment conditions and the dismissal.

### RIGHTS AND PRIVILEGES OF A LABOUR UNION REPRESENTATION

The employees and the labour representatives can organize the elections of employees' delegates, who discuss the employment conditions and the dismissal.

Bulgarian labour law regulates certain rights for the union representatives, for example:

**a. The right to participate in the discussion of the questions, concerning the work and insurance relationship in the company.**

**b. Access to the information about the company, concerning the positions of the employees**

The Labour Code grants the employees' representatives and union representatives specific protection against dismissals. The working conditions of the employees' representatives and the union representatives cannot be changed without their prior agreement.

At the request of the employees, the employees' representatives can represent them in court cases.

## • Collective Bargaining Agreements and Other

### ► Classes

*Labour Code provides different types of employment agreements, individual employment agreements and collective employment agreement. The labour relations between employers and employees can govern at the level of each branch or field of industry by the provisions of national, regional or company collective*

### ► Is Collective Bargaining Agreements binding for the labour contracts?

*The Collective Bargaining Agreements are binding for all employees who signed the agreement and for all labour contracts in the case that the provisions of law are not more favourable to employees than the provisions of the applicable Collective Bargaining Agreement*



## • Wages and Other Types of Compensations

*/Wages, Social Security contributions, remuneration in kind, insurance policies, pension plans/*

### ► **Classes of wages**

*Labour Code provides different types of employment agreements, individual employment agreements and collective employment agreement. The labour relations between employers and employees can govern at the level of each branch or field of industry by the provisions of national, regional or company collective*

### ► **Minimum salary in 2017**

*Recently, the Bulgarian government has set the minimum salary which to be paid to an employee at the amount of 460 BGN / around 230 euro/ monthly for a full time job. It is possible for the employees and employers to stipulate higher minimum salary in the provisions of the Collective Bargaining Agreement. The employer has no fixed annual credit of overtime hours per employee.*

### ► **Cost of Overtime Hours**

*The additional overtime work of the employee must obtain the appropriate payment. Labour Code provides the payment rates:*

- overtime work on workdays has to be extra paid with 50 % of the contract salary
  - overtime work on weekends has to be extra paid with 75 % of the contract salary
  - overtime work on official holidays has to be extra paid with 100 % of the contract salary
  - overtime work, regardless of whether it was performed on workdays, on weekends or on official holidays, when the labour contract was signed for work at working time, calculated on a weekly or longer basis, has to be extra paid with 50 % of the contract salary
- \*Some Collective Bargaining Agreements may provide for different rates.*

## • Employment Regulations

The employment regulations, collective bargaining agreements, overtime work, salaries and holidays are regulated and codifies within the Labour Code.

The Labour authorities such as Ministry of labour and social cares and Labour inspectorate exert control over the applications of the labour regulations.

## • Social Security

### ► **Contribution forms (terms and procedures).**

*According to the Bulgarian Social Security Code social security contributions must be paid every month. Social security payment is divided between the employer and the employees as the percentage is:*

- The employer must pay 60 % of the social security
  - The employee must pay 40 % of the social security.
- \*The percentage varies according to the age of the employees and the branch of industry they work. The percentage may also vary every year upon a government decision

## • Health and Safety

### ► Essential duties of the Company

*According to the Bulgarian Social Security Code social security contributions must be paid every month. Social security payment is divided between the employer and the employees as the percentage is:*

- The employers are obliged to provide their employees with safe and healthy work place.
  - The companies must protect their employees against all kind of accidents. The employers provide the employees with adequate tools and security training. The employees are insured against different accidents.
  - The Labour Inspectorate and other authorities exert regular controls over the work conditions.
  - The employees in some branches of industry /for example mine industry/ are better protected and the Labour Code provides special health and security training, depending on the nature of their activities.
  - When accidents occur on the work place, the employer must declare the accident. The company is obliged to hold responsibly for the damages, suffered by employees.
- \*Health contributions are as follows:  
3.2 % - paid by the employee  
4.8 % - paid by the employer

### ► Main Regulations

*Labour Code and Social Security Code comprise general regulations of health and security conditions.*

## • Contracting and Outsourcing of Work or Services

Upon discretion of the companies, some tasks within the company may be provided by consultants, agents or sub-contractors on the base of outsourcing.

# Bulgaria | REAL STATE

Bulgarian real estate law is regulated mainly in the Bulgarian Constitution, the Ownership Act and the Agricultural Land Ownership and Use Act. The legislation as a whole regulates certain restrictions on acquisition by foreigners, who are citizens of/registered in countries outside of the European Union. However, in this regard, the law treats Bulgarian and EU citizens in an equal manner.

A register of transactions dealing with real estate is kept in the Property register. The whole variety of deeds and mortgages, which are drafted by and signed before a notary must be kept in the Register. According to the envisage of the legislation, the register is organized by real estates, but currently the old 'personal system', that uses the names of the owners of real estates is much more reliable in its data. Costs of real estate transactions /notary's fees, taxes and other duties/ are approximately up to 4.5 % of the value for a sale, 1% for a mortgage/

## • Types of Ownership

The ownership in Bulgaria is absolute. The title to a real property is an absolute and entire right, that is comprised of three separate powers: to use the property, to possess the property and to dispose of it.

The absolute entire title to real estate can belong to a single person / legal or natural entity/ or a collection of individual owners, where each of them owns an ideal portion of the whole with no direct and precise right over a specific part of the real estate.

Bulgarian law of estate regulates some types of limited ownership:

- Right of use
- Right of building
- Right of passing

## • The Property Register

Real property in Bulgaria is registered in special well-organized public Property register. The changes in the legal status of a parcel (transfers of title, liens, mortgages, etc.) are entered into the Property Register of Bulgaria. This Register is maintained by the Registry Agency, which is a state body with Regional offices throughout the country. The Property Register itself is unified, therefore kept at a national level, and the Agency provides electronic services for citizens, who can simultaneously receive detailed record for all changes in the status of a real estate, regardless of where in the country it is located. However, some services are provi-

ded only by the Regional office of the Registry Agency, according to where the property is located, such as: processing the application for obtaining a property (or other changes in it), providing copies of the recorded deeds and issuing of official certificates for existence or lack of limitations on the right of ownership over a property.

## • Transfer formalities

The transfers of titles, mortgages or other changes in the legal status are only enforceable against third parties as from their registration in the Property register.

The right of ownership of real estate is transferred in the form of a notary deed. The notary deed is a type of contract, which form and content are prescribed by law. In order to be registered with the Property registrar, the deeds, mortgages, etc. must be drafted by and signed in front of a notary within whose region the real estate is located. As the notary is under obligation to check the identity of the parties, their capacity, the authority of the representatives and the title of the transferor, the process of execution of the notary deeds offers considerable security. For all transactions with real estates the signing in front of a notary is compulsory. Some exceptions are provided in the law: orders, issued by the administration, mortgages, ordered by the court, court resolutions and orders, award decrees, etc.

Payment of the price – since 01.07.2011 there is a new rule in force – payments in real estate transactions of a total amount exceeding BGN 10,000 shall be transferred to a special bank account of the notary public or to a bank account held with a bank chosen by the parties. Also, in any deals with estimated value over 30 000 BGN, the purchaser is required to sign an affidavit, stating the origin of the money.

Upon execution of the notary deed certain taxes, stamp duty and fees are due. A local tax levied upon the price agreed between the parties and included in the deed or the valuation of the property by the tax authorities, whichever is higher, is due. The notary fee is calculated according to rates specified in the law, depending on the price indicated in the title deed. Thirdly, a stamp duty need to be paid to the Registry agency.

## • Mortgages

A mortgage is established over real property to guarantee financial obligations. According to the Bulgarian property law the mortgages are concluded in a formal act – deed. The mortgages are registered in the Property register.

The mortgage has the following legal effect:

- In case the mortgage is not paid, the holder of a mortgage seizes his debtor's real property and sells it at auction.
- If the owner of the real estate transfers it to another person, without settling the debt, covered by the mortgage, the mortgage is in force for the new owner and the mortgage holder may seize the real property from the new owner and have it sold at an auction.

Both kind of mortgages, stated below, allow the mortgage holder to act on the mortgage, despite multiple transfers and seize it in the hands of the owner whoever that may be.

- The holder of the mortgage is a preferred creditor, according to the Bulgarian law – this means that the holder has the right to be paid by preference over other creditors. This preference refers to the ordinary creditors and to the creditors, whose rights are registered at a later date.

There are two types of mortgages:

### ► **Contractual Mortgage**

*A debtor agrees by contract to allow the holder of the mortgage to register a mortgage over his property on a deed, signed by a notary.*

### ► **Mortgage by Operation of Law**

*This type of mortgage is established in absence of debtor's agreement under certain specific cases, determined in the statute.*

## • Restrictions on acquisition

Bulgarian legislation used to regulate restrictions on acquisition of real property in Bulgaria by all foreign natural persons and legal entities. However, amendments in the Bulgarian Constitution were adopted, in force as of 01.01.2007, providing that foreign legal and natural entities may acquire land in Bulgaria under the terms, arising from the accession of the Republic of Bulgaria to the European Union. . Therefore, the legislation was gradually changed, and currently Bulgarian and EU citizens/companies may acquire real property under the same conditions. The

only specific is with regards to the acquisition of agricultural land, where the law stipulates that such land may be purchased by natural or legal persons, who have been resident or established in the Republic of Bulgaria for more than 5 years. The European Commission has revised this regulation and has decided that it sets forth an active restriction on buying agricultural land for many EU citizens; therefore officials from the relevant Ministry have already made an announcement in 2017 that a bill is being prepared for changing the law accordingly.

Next, it should be noted that foreign natural or legal entities from countries, outside of the EU, are not permitted to buy land in Bulgaria, but they can buy buildings without any restrictions. On the other hand, though, Bulgarian legal entities with partners /shareholders foreign persons or companies are permitted to buy land, with only the exception of agricultural land, and the reality is that through the years a roster of foreign investors made use of this allowance in the legislation and bought land in Bulgaria for the purposes of the business that they established here. . . Pre-emptive rights arise in certain cases, provided for in the Bulgarian law of estate. If a co-owner has made the decision to sell his/her part of the real estate, the aforementioned co-owner is obliged to offer his/her part to the other co-owner/ co-owners before offering it for sale to anyone else.

#### ► Special Legal Protections for parties

*If the buyer considers that the transaction of a real estate is tainted in some way, he may dispute the validity of his purchase in the court. The taint – reason for petition can be, for example:*

- An error, concerning the important characteristics of the property misrepresentation: the seller fraudulently mislead the buyer about the core clauses of the deal violence /physical or mental / voids a sale.
- Lack of consent.
- Contradiction to the law.
- Breach of the required form.

*The buyer may claim avoidance of the sale if the property is not suitable to be used for the purpose that it was bought for, including when there are legal restrictions, obstructing the full adequate use of the property, such as a prohibition to build on land.*

## • Leases

Leases agreements are frequently concluded in Bulgaria. Real property can be rented under lease agreements.

The Bulgarian Contracts and obligations act regulates residential and commercial leases, providing the maximum lease term of 10 years for non-commercial transac

tions, as well as setting forth the obligations and rights of the tenants and lessors. It should be noted that even though the parties may conclude the lease contract only to be in force for a specified term, if the lessee continues to use of the property without the objection of the lessor after this term has expired, the contract is deemed extended for an indefinite term.

The notary form is not compulsory for the lease agreement. Rural leases are regulated generally in the same way, with some conformities due to the specifics of the contractual relations: the lessee acquires any fruit, produced from the land; there is a minimal term for such a contract – 5 crop years (a crop year starts on the 1st of October, instead of the 1st of January); the signatures of the parties must be notarized and the contract – entered into the Property register, etc.

- **Zoning, building permits, etc.**

Every building /residential and commercial/ requires a prior permit, issued by the local municipal and administrative authorities, which ensures that the technical specifics of the building correspond to the detailed land plan, zoning rules and regulations. The land is classified in different categories /for example urban, farmland, forests or protected land/.

The last decade was marked by a series of purposeful actions that lead to the successful zoning and mapping of all the cities and major towns in Bulgaria and the effort to zone and map the entire territory of the country is presently continuing. The reform involves the implementation of a Cadastral map, which includes all land properties with their boundaries, all buildings, technical infrastructure installations, streets, etc., which are individually marked on the map by a unique number (property identification number). On the other hand, the cadastre register contains information on the properties' most important parameters, such as measures, address, neighboring properties and others. The Cadastral map and register are public and an internet platform, kept by the leading authority in the Cadastral survey the Cadastre agency, provides easy and secure access to them. The Cadastral map and register, together with the Property register create a complete picture of the existing properties on the territory, their features and their owners and it is worth noting that the map and registers are synchronized, which means that information from one source is used to fill the data in the others.

## • Wills

A will, signed by a foreigner before a notary public in Bulgaria is recognized. A will, signed abroad, is recognized in Bulgaria if one of the following is met:

1. The will is valid under the law of the country, where the will is executed.
2. The will is valid under the law of the country, which is generally applicable to the person at the moment of the execution of the will or at the moment of his death.
3. The will is valid under the law of the country, where the person has his domicile or permanent abode at the moment of the execution of the will or at the moment of his death; A foreigner may also choose the applicable law. This shall be done in a separate statement in the will itself provided this statement is signed independently from the will statement.

The following Regulation is part of the Bulgarian legislation as per the its terms:

Regulation (EU) No 650/2012 of the European Parliament and of the Council of 4 July 2012 on jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments in matters of succession and on the creation of a European Certificate of Succession.



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## General Information

Founded in 2011, HazloLaw – Business Lawyers is a leading Canadian boutique business law firm headquartered in Ottawa, Ontario. The firm practices exclusively in the areas of business law, tax litigation and international law. Collectively HazloLaw's lawyers have more than 50 years' experience representing clients in a wide array of different matters including corporate governance, commercial contracting, tax planning, strategic transactions, mergers, acquisitions and international disputes, among others. HazloLaw-Business Lawyers prides itself on taking a personalized approach to client services and delivering practical advice to clients based on their unique business needs.

📍 283 Promenade Sussex Drive  
Ottawa, Ontario, K1N 6Z1,  
Canada

☎ +1 613 747 2459

☎ +1 613 691 1475

dpaterson@hazlolaw.com  
maquilina@hazlolaw.com

[www.hazlolaw.com](http://www.hazlolaw.com)

A variety of legal arrangements may be used to carry on commercial activities in Canada. These include sole proprietorships, partnerships, limited partnerships, corporations, franchises and joint ventures. As well, there are a number of different legal methods of carrying on non-profit activities; groups having objects of a religious, philanthropic, charitable, scientific, artistic, social, professional or sporting character may operate as unincorporated associations or non-for-profit corporations. This chapter will discuss the legal characteristics of a corporation with share capital, which is the business entity used most frequently to carry on commercial activities in Canada.

## THE CORPORATION AND SHAREHOLDER LIABILITY

A corporation is a legal entity separate in law from its owners, the shareholders of the corporation. A corporation may own property, carry on business, incur liabilities, and possess rights such as the right to sue in its own name. A corporation has perpetual existence beyond the lifetimes of its shareholders, officers and directors; it exists until it is dissolved. The shareholders own the corporation through their ownership in shares but do not own the business or the property belonging to the corporation, and the rights and liabilities of the corporation are not the rights and liabilities of the shareholders. The shareholders are said to have “limited liability” because their liability in connection with the property or business owned by the corporation is limited to the value of the assets (money, property or services) they have transferred to the corporation in exchange for shares in the corporation. It is only in exceptional circumstances that the courts will look behind the separate legal personality of a corporation and impose personal liability on a shareholder, such as where a corporation has been incorporated for an illegal, fraudulent or improper purpose. Outside of these exceptional circumstances, a shareholder’s liability to creditors of the corporation is limited to the amount of his or her investment and his or her personal assets are shielded from being used to satisfy the liabilities of the business. That said, if a corporation requires financing, lenders will often seek personal guarantees from major shareholders before making loans to a corporation, particularly if it has few assets of its own. Such guarantees can expose a shareholder’s personal assets. Normally though, not all corporate debts will be guaranteed by the shareholders as, for example, debts to trade creditors.

## STATUTES THAT GOVERN CORPORATIONS

Canada has a federal system of government, and it is therefore possible to incorporate at either of two levels:

1. Federally, under the Canada Business Corporations Act (the "CBCA"); or
2. Provincially or territorially, under the relevant legislation in each province or territory (Canada is divided into 12 provinces and 3 territories), such as the Business Corporations Act of Ontario (the "OBCA").

Once having chosen the corporation as the appropriate form of business entity, one must consider in which jurisdiction to incorporate. For the purpose of this chapter, it will be assumed that the choice is only between the federal and Ontario jurisdictions.

The CBCA provides for a right to incorporation through the issuance of Articles of Incorporation. A federal corporation may, subject to the licensing requirements (if any) of each province, carry on business anywhere in Canada and use its name in any province as of right. Federally incorporated corporations must have a minimum of one director in the case of privately held corporations, and three directors in the case of corporations that offer their securities to the public and whose issued securities are held by more than one person. Directors must be natural persons. For public corporations, at least two of the directors must not be officers or employees of the corporation or any of its affiliates. Directors are responsible for the management of the business and affairs of the corporation. There is also a general requirement that at least 25% of a corporation's directors be resident Canadians, or if the corporation has fewer than 4 directors, that at least one be a resident Canadian, with the concept of "residency" being defined in the statute. This is the case even if a corporation is foreign-controlled. However, in the case of a holding company earning less than 5% of its consolidated revenue in Canada, only one-third of the directors need be resident Canadians. In certain industries that are subject to ownership restrictions (such as airlines and telecommunications) or corporations in certain cultural sectors (such as video or film distribution), corporations must have a majority of resident Canadian directors.

Ontario corporations are also incorporated by Articles of Incorporation, which the applicants are entitled to as of right. An Ontario corporation must either register or obtain an extra-provincial licence in order to carry on business in any other province and, unlike a federal corporation, this registration or licence may or may not be granted if the name of the Ontario corporation is not acceptable in the province where the application for registration or licence is being made. An Ontario corporation that is not offering its securities to the public need have only one director, who need not be a shareholder. An Ontario corporation that is offering its securities to the public must have a minimum of three directors, at least

one-third of whom shall not be officers, directors or employees of the corporation or its affiliates.

As under the CBCA, at least 25 percent of the directors of an Ontario corporation must be resident Canadians, or if the corporation has fewer than four directors, at least one must be a resident Canadian. Furthermore, in the context of an Ontario corporation, unless the Articles of Incorporation otherwise provide, a majority of directors' meetings in each fiscal year must be held in Canada. Quorum for a meeting of directors is often set out in a corporation's by-laws, and if it is not, quorum will by default be a majority of the directors (or the minimum number of directors) of the corporation, and in no case may quorum be less than two-fifths of the total (or minimum) number of directors. A resident Canadian is defined in the legislation as an individual who is resident in Canada and is either a Canadian citizen or, in certain circumstances, a permanent resident.

## **BRANCH OPERATION**

It is possible to do business in Canada without incorporating by carrying on business through a "branch operation". In order to do so a company must register as an "extra provincial corporation" in Ontario and any other province in which it carries on business. The provincial naming rules apply to branch operations, meaning that the corporation's corporate name may not be registered in a province if it is the same as or similar to one that is already in use in that province, and in Quebec, a foreign corporation must register a French language name. Depending on the nature of the activities undertaken, provincial registration may be required even if the corporation does not have a "permanent establishment" in the province for income tax purposes. While there is provision for penalties for failure to register, we know of no instance where such provision has been invoked and a penalty levied. If unregistered, however, an extra provincial corporation is not capable of registering an interest in land or maintaining a proceeding in a court in Ontario in respect of any contract made in whole or in part in Ontario in connection with business carried on in Ontario. It should be noted that if a company carries on business in Canada through a branch, it is required to keep books and accounting records at the Canadian place of business and to open such records upon request for audit by Canadian taxation authorities.

## **PROCESS OF INCORPORATION**

Incorporation under both the CBCA and OBCA is accomplished by delivering Articles of Incorporation in the form prescribed in the regulations to the appropriate government department, together with the required supporting material and fees. The Articles must contain the following information about the corporation: name, registered office address; number of directors and the name(s) of the first director(s); restrictions on the nature of the business that can be carried on by the

corporation (if any); the corporation's capital structure; and restrictions on the transfer of shares (if any). On receipt of the Articles conforming to the applicable regulations, the applicable government authority issues a Certificate of Incorporation to the corporation and the corporation comes into existence on the date shown on the Certificate. Once the Articles have been processed, both the CBCA and OBCA require that certain corporate records must be kept by the corporation, including a copy of the Articles and by-laws and all amendments thereto, registers indicating the owners of shares and recording all share transfers, a copy of any unanimous shareholder agreement known to the directors, minutes of meetings and resolutions of shareholders, copies of certain notices required by the statute, adequate accounting records and records containing the minutes of meetings and resolutions of the directors and any committee thereof. The Ontario statute also requires the corporation to maintain a director's register, although it is commonplace for corporations in any Canadian jurisdiction to do so. Except for the Articles, the corporate records listed above are not public documents. Recent amendments to the OCBA also require Ontario corporations to maintain records of all real property held by those corporation. Unlike other records of the corporation, this real estate register must be kept at the registered office of the corporation and must include information about the acquisition of the real property by the corporation, and certain information about the real property itself such as the municipal address, property identification number, legal description and tax roll number.

It is typical to prepare a general by-law to fix the general rules governing the operation of the corporation, for example, meetings, notice, quorum for meetings, officers, proxies, execution of documents and other matters of a continuing nature.

The corporation may change the corporate characteristics set out in its Articles such as the corporation's capital structure. The general rule is that the Articles can be amended only by means of a special resolution passed by the shareholders. A special resolution is defined as a resolution passed by two-thirds of shareholders who voted in respect thereof at a meeting of shareholders, or a resolution that is signed by all the shareholders who are entitled to vote on that resolution. After a special resolution amending the articles of a corporation has been passed, Articles of Amendment that contain the amendment must be sent to the appropriate government department, which will then issue a Certificate of Amendment to the corporation. There are a few exceptions to the general rule that a corporation's articles must be amended by a special resolution. For example, a change in the directors or in the address of the registered office usually do not require an amendment to the Articles. Instead, only a notice of such changes is sent to the appropriate government department.

Unless the Articles, by-laws or a unanimous shareholder agreement provide otherwise, the directors of a corporation may make, amend or repeal any by-laws that regulate the business or affairs of a corporation. A by-law or an amendment

or repeal of a by-law is effective as soon as a directors' resolution is passed at a meeting or signed by all the directors. Once the directors make, amend or repeal a by-law, they must submit the by-law to the shareholders of the corporation at the next meeting of shareholders. The shareholders will then confirm, reject or amend the by-law. If a by-law, or an amendment or repeal of a by-law is rejected by the shareholders, or if the directors do not submit the by-law, amendment or repeal to the shareholders, it ceases to be effective on the date of rejection or on the date of the meeting of shareholders at which it should have been submitted. A by-law or an amendment to or repeal of a by-law may also be proposed by any shareholder entitled to vote at a meeting of shareholders. If the by-law, amendment or repeal is passed at a meeting of shareholders, it is effective from the date of such adoption, and no action by the directors is required. An ordinary resolution of shareholders is required to approve or confirm a by-law or an amendment or repeal of a by-law. If it is desirable to create rules which cannot be altered except by a greater majority of the shareholders, those provisions can be included in the Articles by way of an amendment, and any future change would then require a special resolution of shareholders.

Both CBCA and OBCA corporations must file annual information returns with the appropriate government department.

## SHARE CAPITAL

A corporation can be incorporated with only one class of shares, which may be designated "by any name that the incorporator wishes. Typically where there is one class of shares, these will be denominated as "common" shares. However, in Canada, the name given to a class of shares does not affect the rights of those shares, although there are certain informal naming conventions that are often followed. Where a corporation has only one class of shares, the rights of the holders of that class of shares must be equal in all respects and must include a specific set of rights which are: (1) the right to vote at any meeting of shareholders of the corporation; (2) the right to receive the remaining property of the corporation on dissolution; and (3) the right to receive dividends if and when declared by the directors of the corporation. Where the Articles provide for more than one class of shares, each of the three (3) rights set out above must be attached to at least one class of the authorized shares, but all of the rights are not required to be attached to any one class. Furthermore, not all classes of shares must have the right to vote at shareholders' meeting. However, the OBCA and CBCA grant voting rights even to non-voting shares in certain circumstances. These circumstances generally refer to situations in which the rights of one class of shares would be prejudiced by the change to the Articles, such as when a new class of shares is declared that has dividend right superior to those of an existing class. In that case, the existing class would have to approve the proposed amendment by two-thirds majority (or unanimously in writing), whether or not that class otherwise has voting rights. If an amendment is approved



by special resolution in circumstances where a class was entitled to vote separately, the shareholders of that class who voted against the amendment are entitled to have the corporation purchase their shares for “fair value”. Other fundamental changes to the corporation also require the approval from each class of shares. These include amalgamations, arrangements, the sale of all or substantially all of the corporation’s assets and the dissolution of the corporation. These changes must be approved by a special resolution of each class of shareholders, whether or not such class of shares otherwise has voting rights.

Most corporations (other than publicly traded corporations) have tight restrictions on the transfer of shares. Such restrictions are usually found in the Articles as well as in shareholder agreements. Typically, the consent of at least the majority of shareholders or directors is required before a share transfer in a private corporation is permissible. Subject to the Articles, by-laws, any unanimous shareholder agreement, and applicable securities laws, the directors may issue shares at any time and to such persons and for such consideration as they determine and may declare dividends at any time.

#### **MEETINGS OF DIRECTORS AND SHAREHOLDERS**

Once the corporation is organized it is customary for the directors to meet at least once per year prior to the annual shareholders’ meeting to approve the corporation’s financial statements so that they can be presented to the shareholders (shareholders do not technically approve the financial statements, but have a right to receive them at each annual meeting).

Except where the articles or the by-laws of the corporation provide otherwise, the majority of the meetings of the directors of an Ontario corporation in any year must be held in Canada. There is no similar CBCA requirement. This requirement is not applicable where a written resolution is passed and signed by all of the directors or shareholders entitled to vote on that resolution, as applicable.

Under both the OBCA and CBCA the shareholders of a corporation are required to hold annual meetings, which must occur within 15 months of the previous meeting. In the case of a CBCA corporation such meeting must also occur within 6 months of the end of the previous fiscal year. Meetings of shareholders of CBCA corporations must be held in Canada unless all shareholders agree to a meeting outside of Canada. For an OBCA corporation, the directors, subject to the Articles and any unanimous shareholder agreement, may determine the place of the shareholders meeting, failing which it will be held at the corporation’s registered office in Ontario. At an annual meeting, the shareholders will carry out certain prescribed business such as receiving and considering the financial statements for the previous financial year, electing directors for the subsequent financial year, appointing auditors for the next year (or, in the case of private corporations, dispensing with

the need to do so), and passing resolutions dealing with any other matters referred to in the notice of the meeting of shareholders. Shareholders may elect directors for a term not exceeding three years. A director not elected for an expressly stated term ceases to hold office at the close of the first annual meeting of shareholders following his or her election. However, if no directors are elected at a meeting of shareholders, the incumbent directors continue in office until their successors are elected. After the shareholders' annual meeting, the newly-elected directors would meet to elect the president and other officers of the corporation. Directors are authorized to fix the remuneration of the directors, officers and employees of the corporation. The directors' discretion in this regard may be limited by provisions in the Articles, the by-laws or a unanimous shareholder agreement.

### **DIRECTORS' AND OFFICERS' DUTIES AND LIABILITIES**

The following is not meant to be an exhaustive review of possible sources of liability for directors and officers, but is merely indicative of the scope of such liability.

A director's duty is owed first and foremost to the corporation. Both legislative statutes and the common law establish the parameters of a director's duties. Some of these duties and obligations, specifically, the fiduciary duty, the standard of care and some of the statutory liabilities, apply with equal force to officers. It is the duty of the directors to manage or supervise the management of the business and affairs of a corporation. Unless provided for in a unanimous shareholder agreement, the shareholders of a corporation cannot usurp the directors' power to manage the corporation. Of course, shareholders can also be directors of a corporation, in which case, they will take on the duties and liabilities of directors. Shareholders can exercise indirect control over the business and affairs of the corporation since they elect the directors.

The CBCA and OBCA impose a fiduciary duty on directors and officers of a corporation with respect to the management and operation of that corporation. The fiduciary duty states that every director and officer must act honestly and in good faith with a view to the best interests of the corporation. This duty recognizes that directors and officers are in a position of trust over the actions of a corporation. In this regard, directors and officers cannot engage in certain activities such as, putting their personal interests in conflict with the best interests of the corporation, competing with the corporation, or taking a corporate opportunity for personal profit that a corporation either could have obtained for itself or was actively seeking. Directors and officers also have a duty to disclose their interest in a material contract or transaction of the corporation.

In addition to the fiduciary duty, directors and officers of a corporation must also meet a minimum standard of care with respect to the exercise of their duties, that is, every director and officer, in exercising his or her powers and discharging his

or her duties, must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The courts have tempered the effect of the duty of care in some respect by developing the business judgment rule. This rule provides that business decisions are presumed not to be a breach of duty in the absence of fraud, illegality, bad faith or conflict of interest on the part of the decision maker, as long as there is a rational connection to a business purpose. The intent of this rule is to prevent courts from second-guessing the business decisions of management with the benefit of hindsight, or from setting a standard of conduct that is so high that it would hinder directors from doing what they think is best for the corporation. Both the fiduciary duty and the duty of care are absolute, meaning directors and officers cannot contract out of, or otherwise excuse themselves from these obligations.

In addition to directors' and officers' fiduciary duties and the standard of care which they must observe, there are other specific statutory liabilities imposed upon directors personally. Many of these specific liabilities are imposed upon directors for making errors which could have an adverse effect on the financial position of the corporation. For example, under both the CBCA and OBCA, directors may not declare a dividend if there are reasonable grounds for believing that after the payment of the dividend, the corporation would become insolvent. If directors pay dividends in these circumstances, they will normally be jointly and severally liable for the amount of dividends paid and not recovered by the corporation. Other errors that expose directors to liability include liability for authorizing the issue of shares for inadequate consideration, an improper loan, payment or an improper indemnity, an improper payment to a shareholder, an improper commission, and an improper redemption, purchase or other acquisition of shares.

A director is not liable for breach of fiduciary duty or standard of care or for any specific liability discussed above if the director acted in good faith in reliance upon financial statements of the corporation which an officer of the corporation or the auditor represents to reflect fairly the financial condition of the corporation, or upon a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by such a person.

Another important statutory liability imposed on directors is personal liability for as much as six months' wages of employees together with as much as 12 months' vacation pay. As a result, if a corporation becomes insolvent, this obligation can result in a significant financial obligation for the corporation's directors.

There are many other statutes which impose civil and criminal liability on directors and officers of a corporation for outstanding liabilities and obligations of a corporation. Most of these are related to matters such as taxation, the environment, employees and reporting requirements.

## PUBLIC COMPANIES

All Canadian provinces have some form of legislation (such as the Securities Act and the regulations made thereunder in Ontario) restricting sales of securities to the public. The term “securities” is broadly defined and includes the shares of a corporation as well as many debt instruments such as bonds, options to acquire shares, etc. In order to trade in a security, a corporation must qualify the securities that will be issued to, and traded by, the public with the appropriate regulatory body (in most Canadian jurisdictions, this body is the Securities Commission) and comply with all the statutory rules and conditions imposed by the regulatory body. Issuers of securities who offer securities to the public (for example, a corporation whose shares are listed for trade on a Canadian stock exchange) as well as certain persons having close connections to the issuer (“insiders”) must comply with all statutory laws and conditions imposed by the regulatory bodies that have jurisdiction over it. Failure to comply can lead to high monetary penalties and criminal conviction.

The process for becoming a publicly traded corporation (technically known as a “reporting issuer”) is somewhat complex. In addition to retaining a registered dealer to underwrite the offering, the distribution of securities requires the preparation and filing of a “prospectus” with the applicable regulatory bodies. A prospectus is a comprehensive disclosure document which is intended to provide full, true, and plain disclosure of all material facts in respect of the securities offered by the corporation. It includes information about the corporation, a description of the share capital and the class of shares or other securities to be sold including their offering price. The prospectus must also contain historical audited financial statements of the issuer.

Canada currently does not have a single central securities regulator. Therefore, an issuer seeking to qualify its securities for sale to the public must file a prospectus with the thirteen provincial and territorial regulators. That said, there exist reciprocal accommodations between the various regulators such that the process is not as onerous as it might sound. Only once the prospectus has been filed and receipts have been issued for it by the regulatory body may the securities be sold to the public. The information contained in a prospectus must also be continually updated to remain accurate. Thus, “publicly offered” corporations or “public companies” are required to comply with the requirements for continuous disclosure. The continuous disclosure regime primarily deals with the publication and distribution of financial information on an ongoing basis and the preparation of informational documents in conjunction with meetings of shareholders. In addition, public companies are required, where a “material change” occurs in the affairs of a reporting issuer, to forthwith issue and file a news release authorized by a senior officer, disclosing the nature and substance of the change, and thereafter file a “material change report” within 10 days of the date on which the change occurred. A “material change” is a change in the business, operations or capital of a company

that would reasonably be expected to have a significant effect on the market price or value of its securities or, a decision to implement such a change by the board of directors (or other persons acting in a similar capacity) who believe that confirmation of the decision by the board of directors (or other persons acting in a similar capacity) is probable.

Securities laws provide for exemptions whereby an issuer is not required to meet all the requirements demanded of a public corporation, and particularly the requirement that securities be qualified by prospectus. In particular, most securities laws have an exemption for private corporations. This is known as the “private issuer” exemption in Ontario. In order to qualify for this exemption, a corporation must have the following characteristics:

- |  |  |  |
|--|--|--|
| <p>1. The constitutive documents of the corporation restrict the rights of shareholders to transfer their shares</p>             | <p>3. The securities of the corporation have only been issued to certain prescribed classes of persons, including:</p> <ul style="list-style-type: none"> <li>• Directors, officers, employees, founders or control persons of the issuer</li> <li>• Certain immediate family members of a director, executive officer, founder or control person (or of a spouse of these persons)</li> </ul> | <ul style="list-style-type: none"> <li>• Close personal friends or close business associates of a director, executive officer, founder or control person</li> <li>• Current securityholders of the issuer</li> <li>• Accredited investors (described in more detail below).</li> </ul> |
| <p>2. The total number of shareholders of the corporation does not exceed 50, excluding current and employees of the company</p> |  |  |

A corporation meets these qualifications it may issue shares to the prescribed groups of individuals mentioned above. Thus, most small to mid-size corporations are able to allow sales and transfers of shares by meeting the above requirements (and not filing a prospectus).

There are a number of other exemptions available under Canadian securities laws, the most common of which is the “accredited investor” exemption. This exemption permits companies to raise any amount of investment at any time from any number of accredited investors who purchase securities for their own account. While there are many classes of accredited investors, the most commonly used are: (1) the class based on the net worth of the investor, under which the investor, either alone or with his or her spouse, has net financial assets (generally cash or securities but not real estate or non-financial personal property) with a value of over \$1 million (Cdn.); and (2) individuals with net income (before tax) in each of the last two calendar years of over \$200,000 (individually) or over \$300,000 (with a spouse) and who in either case has a reasonable expectation of the same level in the current year; and (3) corporations, partnerships, limited partnerships or other entities with net assets of at least \$5 million (Cdn.) as indicated on its most recently prepared financial statements.

Other commonly used exemptions are the “Family, Friends and Business Associates” exemption which is available to close relatives, personal friends and business associates of the issuer’s directors and officers, where the investor can demonstrate that they have a sufficiently close relationship to fall under the exemption; and the “Minimum Amount Exemption”, which allows for the issuance of shares to investors who invest at least \$150,000 in securities of the issuer.

## TAXES ON CORPORATE INCOME

In Canada, corporations may be subject to both federal and provincial income taxes. Unlike individuals, which are subject to progressive tax rates, corporations are subject to flat rates of tax. The tax rate payable by a corporation depends on the type of corporation and the source of its income. The federal income tax payable by a corporation pursuant to the Income Tax Act (Canada) (the “Tax Act”) is comprised of the basic federal corporate rate and the federal corporate surtax. Currently, the basic federal corporate rate is 38% minus a provincial abatement of 10%. However, this abatement only applies where a corporation earns income that is attributable to any province in Canada. In 2017, the basic federal rate after applying the provincial abatement is reduced to a net rate of 15%, but only on certain income, and excludes income earned from a personal service business or from a corporation that is, throughout the year, an investment corporation or a mutual fund corporation, as defined in the Tax Act. Financial institutions and insurance corporations with permanent establishments in Canada that have taxable capital employed in Canada in excess of \$1 billion are subject to a capital tax at a single tax rate of 1.25%.

In Ontario, a provincial tax of 11.5% is imposed under the Corporations Tax Act (Ontario) on corporations carrying on business through a permanent establishment in the province. A corporation will have a permanent establishment in a province if it has a fixed place of business there. It may also have a permanent establishment in certain other circumstances, such as when it carries on business through an employee or agent, or uses substantial machinery or equipment in a province.

## CORPORATE RESIDENCE

The application of Canadian income tax is based on a taxpayer’s residence. Tax residency under the Tax Act is a question of fact and is established based on the location of the “central management and control” of the corporation. Moreover, the Tax Act provides for deeming rules whereby a corporation may be deemed resident in Canada. For instance, a Canadian subsidiary incorporated in Canada after April 26, 1965, or prior to that date if it carried on business or was resident in Canada at any time thereafter, is considered to be resident in Canada for tax purposes and is taxed in Canada on its world-wide income regardless of where such income is earned. The subsidiary is subject to Canadian federal income tax as well as provincial income tax in any province in which the company maintains a permanent establishment.

A non-resident corporation which carries on business in Canada is subject to Canadian income tax on the portion of its world-wide income earned in Cana-

da. However, Canada has entered into numerous tax treaties which may affect the foregoing principle, for example by providing that the business profits of corporations resident in a treaty country are only subject to tax in Canada if they are attributable to a permanent establishment in Canada. The application of branch taxes is usually subject to modification in Canada's international tax agreements.

## OTHER TAXES

### a. Sales taxes

Sales taxes are imposed by federal legislation and also by all provincial governments with the exception of Alberta.

Since 1991, Canada has had a value-added sales tax on goods and services ("GST"), which is provided for in the Excise Tax Act (Canada). GST is imposed at a rate of 5% on the consideration paid in respect of virtually all goods and services provided in Canada. Generally, the tax is paid by the purchase of the good or service to the vendor, who collects the tax on behalf of the government. The vendor is entitled to claim a credit for the GST paid by the purchaser in respect of the GST paid by the vendor itself on goods or services acquired for the conduct of the vendor's commercial activity in Canada. The difference between the total amount collected by the vendor from its clients and the total amount paid by the vendor to its suppliers is remitted to the tax authorities. In the case of goods imported into Canada, the GST is paid to the taxing authority directly, based on the duty-paid value of the goods, with an off-setting credit available to a registered importer in respect of the GST paid, provided the goods are used by the importer for a commercial activity in Canada.

No GST is paid on basic groceries, prescription drugs, medical and educational services and residential rents.

Some provinces such as Ontario have chosen to harmonize their sales taxes with the GST, resulting in a combined sales tax referred to as the harmonized sales tax (the "HST"). For example, the HST is levied on supplies made in the province of Ontario at a rate of 13%, consisting of an 8% Ontario component and a 5% federal component.

### b. Excise taxes

The Excise Tax Act (Canada) provides for excise taxes on four products imported into or manufactured in Canada: beer, wine, alcohol and tobacco. Most of these taxes are *ad valorem*, meaning that they are imposed on the value of the good as opposed to their quantity or volume.



## **BRANCH INCOME**

It is possible for a foreign enterprise to do business in Canada without incorporating a company in Canada by operating through a “branch operation”. In such case, the enterprise would be required to register as an extra-provincial corporation in Ontario and any other province in which it carries on business. Depending on the nature of the activities undertaken, such registration may be required even if the corporation does not have a permanent establishment for income tax purposes.

A non-resident corporation that carries on business in Canada is generally subject to corporate income tax at the same rates as similarly situated Canadian resident corporations (as discussed above). In addition a non-incorporated branch may also be subject to an additional 25% branch tax (subject to potential rate reduction under a bilateral tax treaty) imposed by the federal government. This tax is imposed on the portion of the branch’s net after-tax Canadian income that is not re-invested in the Canadian business. This tax measure is intended to eliminate the more favourable tax treatment of branches relative to that of subsidiaries by effectively taking the place of the 25% withholding tax which is levied on dividends paid by a Canadian subsidiary to its non-resident parent. The branch tax may be more onerous though in that it is payable in the year in which income is earned regardless of whether the income is in fact distributed to the parent in that year. Withholding tax, on the other hand, is only payable when a dividend is paid, such that the tax can be postponed until actual payment.

## **INCOME DETERMINATION**

The Tax Act provides that a taxpayer’s income from a business or property is the profit from that source for the taxation year. “Profit” is to be computed initially using applicable general commercial and accounting norms, but is subject to many specific adjustments under the Act.

## **DEDUCTIONS**

Generally, in order to be deductible, expenses must be incurred in the year for the purpose of gaining or producing income from business or property and they must be reasonable in the circumstances. In general, only current expenses are deductible in computing taxable income. Capital expenditures are not generally deductible, but an amount representing depreciation may be deducted pursuant to the capital cost allowance regime contained in the Tax Act and the Income Tax Regulations.

## INTER-CORPORATE LOANS

Particular consideration should be given to loan transactions between a non-resident parent company and its Canadian subsidiary and to interest charged with respect to such loans. The Tax Act generally disallows the deduction of interest payable by a Canadian subsidiary on debts owed to specified non-resident persons, to the extent that the ratio of such debt to the subsidiary's equity exceeds 1.5:1. A "specified non-resident" is any non-resident who owns, or is related to a person who owns either 25% or more of the voting shares of the Canadian-resident corporation, or 25% or more of the fair market value of all of the issued and outstanding shares of the capital stock of the corporation. Special rules apply to debts owed to partnerships of which the Canadian-resident corporation is a member and debts owed to non-resident corporations and trusts that carry on business in Canada.

## INTER-COMPANY DIVIDENDS

Generally, dividends received by corporate shareholders are included in income but are deducted when calculating taxable income. This deduction prevents tax from being paid many times over on the same amount. Dividends will only be taxed in the hands of the ultimate shareholder who is an individual. However, this treatment is reserved to dividends paid by taxable Canadian corporations or by corporations residing in Canada which are controlled by the corporate shareholder. The Tax Act generally imposes a 25 per cent withholding tax on dividends paid by a Canadian subsidiary to its non-resident shareholder, subject to potential rate reduction under a bilateral tax treaty.

## TAX INCENTIVES

A Canadian-controlled private corporations ("CCPC") is entitled to claim a small business deduction on active business income (ABI) earned in Canada. A CCPC generally includes a private corporation resident in Canada that is not controlled by one or more non-residents and/or public corporations. The small business deduction is a reduced rate of tax that is available on active business income earned by a CCPC, but only on the first \$500,000 of active business income. Such incentive is reduced on a declining basis when a CCPC's taxable capital reaches \$10 million, and is eliminated when taxable capital reaches \$15 million.

Generous tax incentives also exist to encourage investment in research and development activities. For example, a scientific research and experimental development investment tax credit is available on qualified capital and non-capital expenditures. This credit can reduce tax payable or even result in a tax refund. CCPCs may be eligible for the credit at a rate of 35% on the first \$3 million dollars of annual eligible expenditures and 15% thereafter. Other Canadian companies are eligible for a 15% credit. To be eligible, the research and development activities must be carried on in Canada. To claim the credit, the taxpayer will require extensive supporting

documentation meticulously showing the various steps, results and conclusions achieved in order to prove that a scientific advancement has taken place.

### **WITHHOLDING TAXES**

Canada imposes withholding tax at the rate of 25% (reduced by most bilateral tax treaties) on various types of “passive” income received by non-residents from Canadian sources. Withholding tax applies to, among others, management or administration fees, interests, dividends, rents and royalties paid by a resident of Canada to a non-resident. There are certain circumstances where a non-resident may be deemed by the Tax Act to be resident in Canada and thus subject to withholding tax on payments made by it to another non-resident.

The Canadian tax system is a self reporting and self assessing system which imposes the obligation on individuals, corporations and trusts to file an income tax return on all taxable amounts for the preceding fiscal year. Individuals are required to file their tax returns each year by April 30, or by June 15 if the individual received business income. Corporations are required to file their income tax returns within six (6) months of their fiscal year-end.

Income tax in Ontario is administered federally; therefore a separate provincial income tax return is not required.

The Tax Act confers upon the Minister of National Revenue a number of powers such as that to require persons to provide information to facilitate the administration or enforcement of the legislation. Typically, the Minister can use special execution measures and enjoys super-priorities vis-à-vis other creditors of a taxpayer who is in default of the Tax Act. The Minister of National Revenue has a duty to examine a taxpayer's income tax return in order to determine whether or not there is applicable tax, interest or penalties due. A notice of assessment is then sent confirming the amount of tax owing or the amount of the tax refund due to the taxpayer. In the absence of fraud or misrepresentation attributable to neglect, carelessness or wilful default, the Minister of National Revenue may not reassess (issue a revised assessment) after three years (or four years in certain cases) has passed since the original notice of assessment was mailed.

# Canada | FOREIGN INVESTMENT

## INVESTMENT CANADA ACT

The Investment Canada Act provides that if a non Canadian person or entity proposes to establish a business in Canada which is either:

- a. Unrelated to any other business being carried on in Canada by that non Canadian, or
- b. Is a related business but is one which falls within a business activity related to Canada's cultural heritage or national identity that has been prescribed by the Government of Canada,

Then a notice of establishment of business must be filed with Industry Canada.

The stated purpose of the Act is to encourage investment in Canada which contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure that such investments benefit Canada.

Notification of the establishment of the business to Industry Canada involves disclosure of information about the non Canadian investor and the business.

If the new business involves an activity relating to Canada's heritage or national identity, the establishment of the business can be made reviewable by the Government of Canada after notice of the new business has been filed. In such case an event, the non Canadian will be required to file an application for review with Industry Canada and to demonstrate that the business will be of net benefit to Canada before being allowed to commence business activities.

If a non Canadian person or entity wishes to acquire an existing Canadian business by way of a direct or indirect acquisition, the Investment Canada Act requires that either a notice or an application for review be filed depending on the manner of acquisition and whether the value of the business being acquired exceeds the prescribed review threshold. For instance, the review threshold for an investor that is not a "WTO investor" as defined by the Act is \$5,000,000 in asset value for direct acquisitions of Canadian businesses and \$50,000,000 in asset value for indirect acquisitions.

All acquisitions involving assets in excess of the thresholds set out above are reviewable transactions. Advice should be obtained prior to entering into any acquisition transaction so that the specific threshold applicable to that business can be determined.

In the case of reviewable transactions, the non-Canadian person or entity is required to file an application for review with Industry Canada and to demonstrate that the acquisition of the Canadian business by that non Canadian will be of net benefit to Canada.

The Investment Canada Act sets out factors to be considered when determining whether net benefit to Canada has been demonstrated. Considerations include the effect of the investment on the level of economic activity in Canada; the degree and significance of participation by Canadians in the business; the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada; the effect of the investment on competition within any industry or industries in Canada; the compatibility of the investment with national industrial, economic and cultural policy objectives as enunciated by the federal or provincial governments; and the contribution of the investment to Canada's ability to compete in world markets. This list is by no means exhaustive, and the circumstances of each investment will result in varying weights being attributed to each factor.

The Investment Canada Act also imposes time limits to ensure the prompt review of applications for review and the issuance of decisions. Non compliance with the Investment Canada Act can lead to the imposition of civil and criminal penalties.

## **COMPETITION ACT**

All businesses operating in Canada are subject to the provisions of the Competition Act, which is Canada's anti trust legislation. The Act envisages the categorization of various anti competitive practices into criminal law prohibitions and civil law matters. Included in the criminal law regime are fraudulent and deceitful practices such as bid rigging, conspiracy relating to professional sport, pyramid selling, and making false or misleading representations. Included in the civil law regime are matters that although not criminal, could potentially impact on competition in the marketplace are therefore undesirable as a matter of public policy. These include provisions relating to price maintenance, refusal to deal, consignment selling, exclusive dealing, tied selling, abuse of dominance (monopoly laws), refusal to supply by a foreign supplier, and enforcement of foreign judgments, laws and directives.

It is to be noted that the last of these matters is of particular relevance to a branch operation in Canada. The Competition Tribunal has the power to forbid the implementation by a Canadian company of a foreign court order or foreign law purporting to direct the conduct of a Canadian company or Canadian subsidiary of a foreign company, if such implementation will have an adverse effect on competition, trade or industry in Canada. Any directive issued by a parent to a branch or subsidiary can be similarly impugned if its effect on Canadian competition, trade or industry is likely to be adverse.

The Commissioner of Competition is responsible for the administration and enforcement of the Competition Act. The Competition Tribunal, in effect a civil court, is responsible for adjudicating civil law competition matters and issuing appropriate remedial orders. The legislation permits the Tribunal to issue consent orders agreed to by the Commissioner and the parties against whom the order is to be directed.

Foreign purchasers of a Canadian company may be subject to examination by the Commissioner of Competition in respect of the competitive effects of the transaction. While all merger and acquisition transactions in Canada are technically subject to examination by the Commissioner of Competition, compared to other jurisdictions, competition review is relatively infrequent. The overarching consideration in these analyses is whether or not the transaction is likely to lessen competition substantially in the market, although the relevant market will vary in type and in scope from one transaction to the next. In most circumstances, particularly in small transactions, no such review will take place. However, the Competition Act includes certain thresholds that if met, make a transaction notifiable, and require the parties thereto to proactively disclose certain information to the Competition Commissioner, such as a description of the proposed transaction, a copy of each legal document that is to be used to implement the proposed transaction, and information about the parties involved.

Where the Competition Tribunal determines that a merger or proposed merger is likely to prevent or lessen competition in the relevant market it can make an order to dissolve a completed merger, to dispose of certain assets or shares, or prevent a proposed merger in whole or in part. Often, to avoid any uncertainty regarding whether their proposed merger will be considered to have an adverse effect on competition, parties to large merger or acquisition transactions will seek an advance ruling certificate from the Competition Commissioner before entering into the transaction, which states that the Commissioner is satisfied that the particular transaction will not adversely affect competition and that the transaction will not be challenged if it is substantially completed within one year of the certificate's issuance.

## **TRADE LEGISLATION**

Imports to Canada are subject to the provisions of a variety of statutes including the Customs Act, Customs Tariff, Special Import Measures Act, Export and Import Permits Act and the Excise Tax Act.

The Customs Act sets out the administration of the Customs Tariff, which lists the tariff items and duty rates applicable to goods imported into Canada.

The Export and Import Permits Act requires import permits for a range of commodities listed in the Import Control List, which includes many agricultural and

textile products as well as many chemicals, firearms and other weapons. There is also an Export Control List which requires permits for exports of a few prescribed items from Canada. These include many advanced technological goods and weapons which may be of strategic value.

Canada's anti dumping and countervailing duty laws are contained in the Special Import Measures Act. The Act provides Canadian industries with recourse to anti dumping and countervailing duties in the event they are being materially injured from goods that are dumped into Canada or benefit from goods that are subsidized by foreign governments.

When goods are imported into Canada, excise tax may be payable by the importer at the time the goods are imported. Excise taxes are charged on fuel-inefficient vehicles, automobile air conditioners and certain petroleum products, and the amount of excise tax payable by importers is set out in the Excise Tax Act.

The previously in-force Canada-U.S. Free Trade Agreement (the "FTA") which was signed in 1988 had an enormous impact on Canada's trade laws vis-à-vis the United States. Several industry sectors, including energy, agriculture, transportation and automotive products, have seen a continuing liberalization of rules pertaining to cross-border trade since it was first signed. This trend has continued under the North American Free Trade Agreement (the "NAFTA"), which came into force on January 1, 1994.

The key feature of the NAFTA is the elimination of duties and certain other restrictions on substantially all trade in goods among Canada, the U.S. and Mexico. The NAFTA did not affect the phase-out of tariffs which had been agreed upon under the FTA. The phase-out of FTA tariffs was completed on January 1, 1998. As a result of the NAFTA, on January 1, 2003 tariffs on trade between Canada, Mexico, and the United States for all eligible goods were eliminated.

Also, the Canadian, American and Mexican regimes pertaining to dumping, subsidies and related trade disputes are subject to a dispute resolution mechanism under the NAFTA. Where a private party notifies its government that it would like to seek binational panel review of an anti-dumping or countervailing duty order, the government concerned is required to initiate proceedings on its behalf.

At the time of writing, the parties have, at the behest of the American administration which contends that the treaty is "unfair", commenced the renegotiation of NAFTA.

Canada has recently signed two other significant international trade agreements, including the Trans-Pacific Partnership (the "TPP") and the Comprehensive Economic and Trade Agreement (the "CETA").

The TPP is a comprehensive trade agreement between Canada and various other countries in Asia, Oceania, and the Americas. The TPP addresses issues such as trade barriers, environmental protection, intellectual property and labour standards. The TPP has yet to be ratified and after the United States' withdrawal on January 23, 2017, its future remains uncertain.

The CETA is a free-trade agreement between Canada and the European Union which was signed on October 30, 2016 and approved by the European Parliament on February 15, 2017. The Agreement has not yet come into force, but when it does it is expected to, among other things, eliminate 98% of the tariffs between Canada and the European Union and provide for stricter enforcement of intellectual property rights. Both parties are expected to apply CETA provisionally starting September 21, 2017.

## CANADIAN IMMIGRATION REQUIREMENTS FOR BUSINESS PEOPLE

### a. General Requirements

Canadian immigration law imposes certain requirements on foreign individuals wishing to work in Canada. These requirements are of particular interest to corporations who wish to transfer personnel to their Canadian branch or subsidiary or those who cannot fill roles locally and want to recruit from outside Canada.

Foreign nationals who are to be temporarily employed in Canada must apply through a Canadian government visa office abroad for a Work Permit, or, alternatively, if they do not need Temporary Resident Visas to enter Canada, at the Canadian border or port of entry. In order to obtain the permit, the Canadian employer must usually apply to Service Canada for a Labour Market Impact Assessment (LMIA). For the application to be approved, officials at the office must make a determination that the individual's admission to Canada will not adversely affect the employment opportunities of Canadian residents and that there is a shortage of suitable Canadian citizens or permanent residents available to fill the position.

Special provisions permit non-Canadians to work in Canada without first obtaining a LMIA from Service Canada, in some exceptional circumstances. Most commonly, the LMIA requirements may be waived in the case of intra-corporate transfers where an employee of a corporation located outside Canada seeks to enter Canada to work in the corporation's Canadian branch or subsidiary at a senior managerial level or a "specialized knowledge" level for a temporary period. In such cases, the company must prove that the employee has worked for the related company abroad for one year in the last three, that the companies have a qualifying relationship and that the employee's role is senior managerial in nature or requires specialized knowledge not readily available locally.

Where an individual's employment will involve a permanent transfer to Canada, he or she should make application for permanent residence in Canada, usually after arriving in Canada on a work permit. Applicants are assessed under a point system which allocates units of assessment based on various selection factors. The selection factors include education, age, knowledge of English or French, work experience in Canada and abroad, job offers, siblings in Canada, etc. These factors combine to create a "CRA" score which Immigration, Refugees and Citizenship Canada ("IRCC") uses to issue "invitations" to apply for permanent residence. The applicant must also meet the criteria for one of the: the Federal Skilled Worker, Canadian Experience or Provincial Nominee classes.

These are special rules for individuals who apply for permanent residence as "self-employed" persons. This category applies to individuals who demonstrate the ability and intent to establish a business that would



make a positive contribution to specified economic activities (cultural activities, athletics or farm management) in Canada. Each province also operates a "Provincial Nominee" program which grants access to permanent residence based on criteria that differ slightly from the federal programs.

Persons admitted to Canada under any of the categories may include in their application members of their immediate families. Immediate family members include the spouse and dependent children – generally those under the age of 22.

**b.Spouses of Foreign Workers**

The spouses of some foreign workers are entitled to work in Canada on "open" work permits. In order for a spouse to be able to work, the principal spouse must be working in a managerial, technical or highly-skilled occupation and have a work permit issued for six (6) months or more. These occupations are listed in a schedule published by the government of Canada.

**c.Work Permit exemptions under Global Skills Strategy**

In June 2017 IRCC announced provisions allowing highly skilled workers and researchers to enter Canada to work, exempt from the need for a work permit. Qualifying workers may only work in Canada for 15 days every 6 months or for a 30 day period every 12 months. Researchers may come to Canada for 120 days every 12 months.

**d.North American Free Trade Agreement**

The North American Free Trade Agreement ("NAFTA") establishes a special regime for temporary entry of business persons workers who are citizens of either the U.S. or Mexico.

Temporary business visitors are classified under the NAFTA into four categories:

i. Business visitors

Business visitors are persons who intend to enter Canada for a temporary period of time equaling six (6) months or less for the purpose of performing certain occupational and business functions and who do not need work permits. Business visitors must not be involved in any hands-on or productive work in Canada other than those who qualify to provide after-sales services for industrial equipment/software sold to a Canadian company by a foreign entity.

ii. Traders and Investors

The "Traders and Investors" classification covers business persons seeking to:

- Carry on substantial trade in goods and services principally between the territory of the Party of which the business person is a citizen and the territory of the Party into which entry is sought; or
- Establish, develop, administer or provide advice or key technical services to the operation of an investment to which the business person or the business person's enterprise has committed, or is in the process of committing, a substantial amount of capital, in a capacity that is supervisory, executive or involves essential skills. Work permits are required but they are LMIA exempt.

## iii. Professionals

Professionals identified in Appendix 1603.D.1 of the NAFTA may obtain work permits exempt from LMIA. The professionals included in this classification extend beyond occupations traditionally recognized as professions to include such occupations as hotel managers, technical publication writers, and management consultants. In some instances, minimum academic or work experience is specified, and the professional activity that may be carried out in Canada is sometimes limited. For example, a U.S. or Mexican physician may only be involved in teaching or research in Canada, and not the active practice of clinical medicine.

A work permit valid initially for one to three will be issued by Canadian immigration officials either at a Canadian consulate or at the port of entry into Canada. The U.S. or Mexican citizen must have documentary evidence of his or her education and professional qualifications as well as documentation verifying the work they will be doing in Canada for a Canadian employer or customer/client.

## iv. Intra-company Transferees

As discussed, Canadian immigration policies currently permit the entry of senior managerial staff or specialized knowledge workers on an intra-company transfer work permit basis, LMIA exempt. Work permits can be obtained either at the border (including airports) or at a Canadian embassy or consulate ahead of time. Employees must be currently employed by and have worked for the related company abroad for one year in the proceeding three. The company in Canada and the company abroad must also have a "qualifying" relationship.

**e. Other free trade agreements**

Canada has also entered into agreements, similar in some aspects to the NAFTA, with Chile ("CCFTA"), Peru (Canada-Peru FTA) and Colombia (Canada-Colombia FTA) and has limited immigration reciprocal arrangements under the General Agreement on Trade in Services ("GATS") as well. Canada has recently entered into an agreement with the European Union (The Canada-European Union Comprehensive Economic and Trade Agreement) ("CETA"). The agreement addresses the liberalization of cross-market "services" and does so in a number of ways including relaxed entry provisions for business visitors and sector-specific provisions for telecom and e-commerce services providers. The Temporary Entry and Stay chapter focuses on reducing barriers (such as LMIA). The chapter discusses, as in the NAFTA, the provisions for business visitors, intra-corporate transferees, investors, contract services suppliers and independent professionals (including a long list of professionals and some technicians). Specific procedures and manuals have not yet been produced to allow use of these provisions.

## CLASSES OR TYPES OF CONTRACTS

There are two main types of employment contracts: the individual contract of employment and the collective agreement. The individual contract of employment is between an employer and an individual. It is the result of either a written agreement setting out all the terms of employment or it can stem from oral representations between the parties. The individual contract of employment is often a combination of oral and written terms.

The collective agreement is defined in the Canada Labour Code, as an agreement in writing entered into between an employer and bargaining agent acting on behalf of the employees (most commonly a union) containing provisions respecting terms and conditions of employment and related matters.

## COST OF DISMISSAL AND WRONGFUL DISMISSAL

An employer generally has the right to dismiss an employee at any time if it has just cause to do so. However, it must at all times respect the contract of employment and applicable legislation. In Ontario, Sections 57 and 58 of the Ontario Employment Standards Act, in particular, must be considered when determining when and how to dismiss an employee. These provisions provide minimum entitlements to employees with respect to the amount of notice of termination which they are owed. The minimum notice entitlements are based on the employee's length of service with the employer, as an employee. For example, if an individual has been an employee for between six and seven years, an employer is required to give at least six weeks of notice before termination. It should be noted that absent a provision in the employment agreement specifically stating otherwise, these minimum notice periods do not prevent an employee from seeking a more substantial notice period at common law. Employers are able to increase the notice entitlements to their employees by contract, but will at all times be bound by the minimum standards regardless of the terms of the employment agreement.

What constitutes "reasonable notice" at common law will vary depending on the circumstances of each case. When determining whether the employee was given a reasonable notice, courts will usually be more generous than the statutory minimums, and will consider factors such as:

- a. The availability of similar employment
- b. The age of the employee
- c. The length of service of the employee
- d. The experience and qualifications of the employee.

For example, an older employee who occupies a high ranked position in a company is generally entitled to a longer period of notice than a young clerical worker as it is expected that more time will be required for them to find replacement employment.

In any event, an employer also has the option of paying an employee wages in lieu of notice. The amount of wages that must be paid is determined by calculating what the employee would have been paid during the notice period to which they would have been entitled. The employee, for his or her part, has a duty to mitigate his or her losses, by taking reasonable steps to find alternate employment upon being given notice of termination.

### **SPECIAL REGIME FOR EMPLOYMENT CONTRACTS FOR DIRECTORS**

In Ontario directors are excluded from the protections offered by both the Labour Relations Act, which governs collective bargaining, and the Employment Standards Act which establishes minimum standards for employees in the employment relationship.

### **EMPLOYEES' REPRESENTATIVES AND UNION REPRESENTATION**

Historically, trade unions emerged out of unacceptable employment practices. They have been the response to the inequality in bargaining power that traditionally exists between the employer and its employees. As a result, unions have enabled workers across the country to establish acceptable work conditions and employment contracts that better reflect the values and the needs of employees. In a unionized context, the individual contract of employment is replaced by the collective agreement.

In Ontario, the Labour Relations Act defines a trade union as “an organization of employees formed for purposes that include the regulation of relations between employees and employers and includes a provincial, national, or international trade union, a certified council of trade unions and a designated or certified employee bargaining agency.”

In order for a union to represent its members' interests, it must be certified pursuant to the Ontario Labour Relations Act. The certification process has several steps which include:

- |  |   |
|--|---|
| 1. Delivery of an application for certification by the union                                     | 3. Delivery of a response to the application by the employer  |
| 2. Service of the application on the employer and filing with the Ontario Labour Relations Board | 4. Service of the employer's response on the union and filing at the Ontario Labour Relations Board |

5. Selection of a date for a certification vote by the Ontario Labour Relations Board
6. The certification vote
7. Delivery of a copy of the vote decision to the employer and the union by the Ontario Labour Relations Board. If a majority of the employees vote for union representation, the union will be certified to represent their interests.

Once certification is complete, the employer will be forced to deal with the union, as opposed to individual employees. Accordingly, the union has the responsibility of looking after the employees' interests.

## **WAGES**

In Ontario, employees may be paid based on an hourly rate, a fixed salary, a fluctuating salary, commission, or a piecework rate basis.

The minimum wage is governed by the Employment Standards Act, which has established the general minimum wage in Ontario for October 1, 2016 to September 30, 2017 at \$11.40 per hour. On October 1, 2017, the general minimum wage will increase to \$11.60 per hour. However, there are other minimum wage rates that apply to certain individuals such as students under 18 years of age, an employee who serves liquor as part of his or her regular work, a hunting or fishing guide and an employee who is a homemaker.

Employers must pay their employees overtime pay equal to at least one and one half times their regular rate of pay for each overtime hour worked in excess of 44 hours each week. It is possible to set a different weekly threshold, provided the employer and employee both agree to do so. For example, if an employee agrees to work a certain amount of hours that will be averaged over a number of weeks and if the employer obtains the approval of this agreement from the Director of Employment Standards, this new threshold will be set for the duration set out in the agreement or in the approval from the Director.

## **EMPLOYMENT REGULATIONS**

In Ontario, the applicable regulations in the context of employment and labour law are the regulations under the Employment Standards Act and the Ontario Labour Relations Act. At the federal level, the applicable regulations are under the Canada Labour Code.

## **SOCIAL SECURITY**

The Canada Pension Plan ("CPP") is an earnings-related insurance plan. Every Canadian over the age of 18 who earns a salary must contribute to the CPP unless they fall into one of the exceptions. There are three main types of CPP payments:

1. Disability benefits
2. Retirement pension
3. Rurvivor benefits.

Unemployment Insurance (“UI”) is a system that was established to provide temporary financial assistance to unemployed Canadians while they search for new employment or while they enhance their skills.

The employer’s maximum CPP contribution for 2017 is set at 4.95% of contributory wages and salaries.

The employer’s UI rate for 2017 is set at 1.63% with a maximum insurable earnings of \$51,300.

The amount that an employee will contribute to his or her CPP varies depending on his or her salary. The maximum pensionable earnings for 2017 is set at \$55,300 and there is a minimum level, which has been frozen to \$3,500. The maximum contribution for an employee in 2017 is set at a rate of 4.95% of contributory wages and salaries. An employee’s maximum contribution to the plan in 2017 is set at \$2,564.10. Self-employed workers must also contribute to their CPP. The maximum contribution for 2017 is set at a rate of 9.9% of contributory self-employed earnings.

The employee contribution rate for 2017 is at 1.63% with a maximum insurable earnings of \$51,300.

Although the rate of pay is higher when an employee works overtime, EI still applies at the employee’s regular rate of pay. Meaning, every hour of overtime worked is the equivalent of one hour of insurable employment.

## HEALTH AND SAFETY

In Ontario, Health and Safety in the workplace is regulated under the Occupational Health and Safety Act, the Workplace Safety and Insurance Act and the regulations enacted thereunder. Employers have a general duty to take every precaution reasonable in the circumstances for the protection of their workers. This duty includes an obligation to provide a safe work environment, to educate and train workers in their workplace, and in some circumstances to provide workers with written instructions in respect of their workplace obligations. Employers must have a written occupational health and safety policy, which must be reviewed annually and be posted in the workplace in a conspicuous location. Employers must also appoint and assist health and safety representatives in the workplace and establish an occupational health service.

Employers must post a copy of the Occupational Health and Safety Act and materials explaining the Act in a conspicuous location in the workplace in English and also in the majority language of the workplace. Employers have a duty to appoint competent supervisors and a duty to employ workers of legal age, which varies from 14 to 18 depending on the industry. Lastly, employers have a duty to keep records of biological, chemical and physical agents in the workplace and the handling, storage, use and disposal of these agents.

### CONTRACTING AND OUTSOURCING

Individuals and organizations will commonly structure their working relationship such that the individual provides services as an independent contractor, either personally or through a company, rather than as an employee. Under this arrangement both parties can realize certain benefits, however, there are risks involved in mischaracterizing an employee as a contractor and vice versa, such as liability for unremitted income tax. In order to determine whether a person is an employee or an independent contractor, the court will evaluate the parties' relationship by considering a number of factors such as:

1. The degree or absence of control, exercised by the alleged employer
2. The ownership of the tools
3. The chance of profit or loss
4. the integration of the alleged employee's work into the alleged employer's business. For example, a person would be considered an employee if the employer exercises a high degree of control such as determining his or her work hours, if the employer owns the tools with which the employee accomplishes his or her work, if the employee has no chance of profit or loss and if the employee's work is an integral part of the employer's business such as a window installer for a windows and doors business.

Employers are able to realize certain benefits from defining relationships with their service providers as independent contractor relationships. These include exemptions from employment standards legislation and requirements related to collecting and remitting statutory deductions from employee pay. As a result, employers will often include language in their contracts which clearly specify an independent contractor relationship, and specifically reject an employer-employee relationship. However, these contractual provisions are not determinative and courts will consider every case based on all the factual circumstances.

## TYPES OF OWNERSHIP

There are two usual forms of concurrent ownership: joint tenancy and tenancy in common. To create joint tenancy four so-called unities must be established, which together describe the need for near perfect equality between or among the joint tenants. Each joint tenant must be equal in nature, extent and duration (unity of interest); their interests must arise from the same instrument or act (unity of title); their interests must arise at the same time (unity of time); and their rights must relate to the same piece of property (unity of possession). The underlying notion is that in a joint tenancy there is effectively only one owner rather than joint tenants holding distinct shares. The most important trait of a joint tenancy is the right of survivorship, the *jus accrescendi*. Essentially, once a joint tenant dies, his or her interest is extinguished. In a joint tenancy, survivorship occurs automatically, by operation of law and therefore is an alternative to a transfer by last will and testament.

For a tenancy in common to exist, unity of possession must exist; however, any of the three other unities may not be present. For instance, there may not be a unity of interest if one-third of the interest in the property belongs to A and two-thirds belong to B. Unity of possession nevertheless remains intact as the individual shares remain undivided during the length of the relationship. There is no right to survivorship under a tenancy in common meaning, when a tenant in common dies, their interest in the property is divided among their heirs, by will or according to the law of intestacy.

If all four unities are present, the question of whether ownership is joint tenancy or tenancy in common will depend on the intention of the predecessor in title or of the tenants themselves. When there is no reference to either form, there is a presumption that the grantor intended to convey the property as a joint tenancy. However, the courts have shown a tendency to favour the tenancy in common. With the result that even the slightest indication by the grantor to create a tenancy in common will rebut this presumption and result in a tenancy in common. The court will determine whether there are any words of severance such as “equally amongst them” “respectively”, “between”, “each” or similar words or phrases which would indicate an intention to create distinct shares of the property. However, in number of jurisdictions, including Ontario, this debate is now moot as property and conveyancing legislation has been enacted imposing a statutory presumption of tenancy in common.



## LAND REGISTRATION SYSTEM IN ONTARIO

Land registration systems provide a uniform method of tracking instruments creating or disposing of interests in land and other instruments that affect the use of land. They serve the very important purpose of providing notice to the public about the various interests that individuals or other entities have in a piece of land. There are two such land registry systems in Ontario: the registry system, governed by the Registry Act, and the land titles system, governed by the Land Titles Act. The key difference between the two is that under the land registry system title to property is based on and evidenced by a set of historical legal instruments which have been deposited on title, key among them being one or more deeds. Under the land titles system on the other hand, each parcel of land is represented by a parcel register, which serves as the primary legal document on which title is based. The parcel register is a document in a prescribed form which provides a legal description, ownership information, and a history of transfers, easements, charges and other events which affect title. The parcel register under the Land Titles system is a document whose content is verified by the government of Ontario and which, subject to certain qualifications, can be relied upon as accurate. In recent years the government of Ontario has embarked on a project to convert all real property parcels to the Land Titles system, and at present nearly all real property in Ontario has been converted to the Land Titles system.

## LEASEHOLD TYPES

A lease has been defined as a demise of land that confers exclusive occupation by a landlord to a tenant. There are five types of leases:

1. Fixed term
2. Periodic tenancy
3. Tenancy at will
4. Tenancy at sufferance
5. Perpetual lease

A fixed term lease is a lease that is for a specific duration with a particular commencement and termination date. A periodic tenancy is a lease that doesn't specify a particular end date, but does specify recurring periods of tenancy. A lease under periodic tenancy can be terminated by notice, the amount of which is typically equivalent to the length of the tenancy period unless it is a yearly tenancy, in which case a six-month notice period is required according to common law. This may vary from province to province depending on the presence of relevant statutory requirements. A tenancy at will does not have a set period or term and continues only as long as the tenant and landlord so desire. Under this arrangement either party has the power to terminate the tenancy. A tenancy at sufferance is the type of lease that tends to arise when a tenant continues to occupy leased property after their lease has expired. This type of lease continues in effect as long as the tenant

remains in occupation of the property and continues to pay rent. A tenancy at sufferance ceases to exist when the landlord asks the tenant to vacate the premises. Perpetual leases, which have no fixed term and no right of termination on notice and can last forever, are very rare, but are sometimes still found in the law such as in certain Crown grants of land.

## LEASE FORMALITIES

There are several characteristics that should be contained in every lease to make it a valid contract. There must be certainty as to the parties (landlord and tenant, as well as any guarantor or indemnifier), the premises to be leased, the commencement and duration of the term, the rent, and all material terms of the contract that are not incidental to, or otherwise implied by the legal relationship between landlord and tenant.

A lease or agreement to lease must generally be in writing and signed by the lessor (not an agent thereof) to comply with the Statute of Frauds. If this requirement is not met a tenancy at will is created provided the tenant possesses the premises with the consent of the landlord. It should be noted that this requirement does not apply to leases for a term of less than three years and, in Ontario, where the rent amounts to at least two-thirds of the rental value. In some Canadian provinces, a prescribed form is used. Due to the unfairness that results from formal requirements, there are several principles in common law that counter the effect of non-compliance. For example, if a tenant possesses the premises under a void lease but pays the rent and the landlord accepts that payment, a periodic tenancy is presumed to be created at common law. In other circumstances, the equitable concept of “part performance” may create a binding oral agreement where a lease is not in writing. In order for part performance to apply, the following criteria must be met:

1. There must be acts undertaken pursuant to the contract asserted
2. The contract, if prepared in writing would have been enforceable
3. There is proper evidence of the existence of the contract
4. Denying a recognition of part performance would enable a party to fraudulently take advantage of the fact that the contract was not in writing

## MORTGAGES AND OTHER SECURITY INTERESTS

A mortgage is an important security interest in real property that is conferred by the mortgagor (the borrower) on the mortgagee (the lender), typically in exchange for a loan used to purchase the real property in question. A mortgage provides the mortgagee with secured real property that it can realize upon if the repayment obligations are not complied with. Generally, legal title to the property will be conveyed to the mortgagee as security and the mortgagor will have a contractual right

to redeem the mortgaged property or interest. However, in Ontario, legislation has reversed this system and provides that the mortgage is viewed as an encumbrance on the legal estate of the mortgagor. In most cases the mortgaged property will be a freehold estate, but can also be a leasehold or other interest such as an easement. Most standard loan transactions in Ontario are conducted with respect to a commitment which contains the standard terms and conditions of the contractual relationship such as the principal amount of the loan, the interest rate, the monthly payments, the period over which the loan is amortized and the maturity date of the charge at which time the amount outstanding must be repaid.

### **ENFORCEMENT OF MORTGAGE SECURITY**

There are a number of remedies available to a mortgagee that is faced with a defaulting mortgagor. These include sale of the mortgaged property (either through power of sale or court order), obtaining title to the mortgaged property (either through foreclosure or acceptance of a "quit claim deed"), taking possession of the mortgaged property privately by court or order, or through a receiver, and obtaining a judgment against the mortgagor or owner of the property, or any guarantors if applicable.

A mortgagee may exercise a power of sale if it is expressly provided for in the provisions of the mortgage. If it does so, the mortgagee conveys the mortgaged property to a purchaser free and clear of the interest of the mortgagor and any other person having an interest in the property which ranks lower in priority than the mortgagee. A sale pursuant to court order or "judicial sale" has effectively the same result. By exercising a foreclosure action, the mortgagee will become the owner of the mortgaged property, and those interests in the property which rank lower in priority to the mortgagee will be extinguished. The decision as to which remedy to pursue will depend on the circumstances of the mortgagee, and will involve considerations of the time required to pursue each remedy (power of sale generally being the most expedient), the cost (including land transfer tax), the administrative burden of dealing with other encumbrancers .... who may raise objections with the process, whether the mortgagee wishes to take control of the property, and the amount of debt owing. On this final consideration it is important to note that under a power of sale or judicial sale, if the sale is not sufficient to recover the amount of debt owing, the mortgagee retains a right to pursue the mortgagor and others to recover the shortfall. Conversely, by obtaining a final order of foreclosure, the mortgagee is deemed to have accepted the property in full satisfaction of the debt. Therefore the mortgagee is precluded from making a claims against the mortgagor for any deficiency.

## TRANSFER FORMALITIES IN ONTARIO

Real estate purchase transactions typically have three stages:

1. Negotiation and drafting of documents
2. The title search and due diligence process
3. Closing of the transaction

During the negotiation and drafting process, the key document is the agreement of purchase and sale which is a written, binding contract that includes all of the key terms of the transaction including a description of the land, the parties, the financial terms, deadlines and closing date, other prescribed terms and any other terms that are of importance to the parties.

Once the agreement of purchase and sale is received the purchaser will typically proceed to search title to the target property. A title search is a process by which all documents that are deposited or registered on title are reviewed to determine whether there are any encumbrances or other interests on title that would be problematic for a purchaser, such as an easement, lien, or mortgage that has not been discharged. A title search will also reveal information such as the legal description of the property, and whether it is in the Registry System or the Land Titles System. Beyond the title search a number of so-called “off-title searches” are also conducted on a property before purchase, which include searches related to the payment of realty taxes, water, sewer and utilities arrears, zoning compliance, work orders and building code compliance.

After completion of the title and off-title searches, a requisition letter is typically written by the purchaser’s counsel to the vendor’s counsel, requesting that certain defects in title be explained or rectified. Vendor’s counsel will then reply to the letter and the parties will typically attempt to resolve any outstanding issues. The form and content of requisitions and replies are tightly prescribed by convention, and should be followed closely.

In preparation for closing the parties will begin drafting the required legal documents and identifying the issues that need to be attended to prior to the closing date. The legal documents that are typically required include the transfer/deed of land, mortgage document, discharge of existing mortgage, direction regarding title, statement of adjustments for expenses that arise post-closing (such as utilities charged up to the closing date), direction regarding funds, an income tax affidavit with respect to the vendor’s residency status; a bill of sale if movable property is also being transferred to the purchaser; an insulation warranty to insure that there is no urea formaldehyde foam insulation in the structure; documentation relating to leases (if any) to indicate whether or not they will be assigned; and any undertakings and other documents dictated by the terms of the transaction.

On closing, the transfer of title to the target property will occur electronically unless the target property is registered under the Registry System in which case the lawyer or an agent will attend the land titles office to deposit the documents on title. Immediately prior to closing the purchaser's lawyer will typically perform a follow-up title search to ensure no additional interests have been registered on title since the initial title search was performed. The purchaser's solicitor will in most cases also obtain an execution certificate for the vendor to determine whether or not there are any writs of execution issued against the vendor which could compromise the purchaser's title to the property. The closing process involves the execution and exchange of documents, and the exchange of keys and funds. Once the executed documents are exchanged the purchaser's solicitors will agree to lift the escrow conditions, register the documents and exchange the keys and funds.

### **TITLE INSURANCE**

Purchasers of real property in Canada will often obtain a title insurance policy to protect them against any losses that may arise from title defects that are not known to the purchaser at the time the property is acquired. Title defects are liens, encumbrances or other rights that a party other than the registered owner has over the title to property. Meaning the existence of an unknown title defect can in many cases compromise the registered owner's rights of ownership over their own property. Title insurance policies help insure against these risks by indemnifying purchasers of property for any damages arising out of title defects that are not discovered until after the property is transferred. Title insurance policies can insure owners, lenders or both, and can vary from one jurisdiction to another and from one insurer to another. Typically title insurers will require the lawyer representing the purchaser to satisfy a number of requirements before the policy is issued. These include searching title, reporting any defects and recently registered instruments, providing the insurance company with certain information about the purchaser, and delivering a final report on title to the insurer.

### **RESTRICTIONS ON ACQUISITION: RESIDENCY OF THE PARTIES**

Non-residents are generally not restricted from purchasing real property in Canada. However, if the vendor is a non-resident, certain special considerations are required. Specifically, if a vendor is a non-resident of Canada, pursuant to the Income Tax Act the purchaser must withhold a portion of the purchase price necessary to satisfy the vendor's tax liability. However, if the purchaser, after due inquiry has no reason to believe that the vendor is a non-resident of Canada it does not need to satisfy this requirement. The position of the Canada Revenue Agency is that "due inquiry" requires the purchaser to take prudent measures to confirm the vendor's residence status. This is most commonly achieved by the vendor providing to the purchaser on closing an affidavit stating that he or she is not a non-resident of Canada within the meaning of the Income Tax Act.

## PLANNING ACT

The Planning Act must be given specific consideration in any transaction regarding the purchase and sale of property in Ontario. In particular, section 50 of the Planning Act creates strict regulations around the control of subdivisions in Ontario. The basic proposition underlying Section 50 is that a person cannot convey interest in land unless it falls within one of the exceptions listed in the Act. The exception most commonly relied on pertains to property that is described by a registered plan of subdivision. Another exception applies to property that is not within a registered plan of subdivision and allows the land-owner to carry out certain transactions (including a sale, transfer or mortgage) only if that person does not retain an ownership right in any land which abuts the target land. This exception has the effect of prohibiting a transaction where the land-owner owns land which abuts the target property. This prohibition commonly requires lawyers to search title on lands abutting the target property in a purchase transaction or seeking certain assurances from the vendor's lawyer in respect of compliance with the Planning Act. Compliance with the Planning Act is of critical importance to any transfer of property in Ontario. If it is not complied with, title will not legally pass from one party to another, regardless whether the purchase or other transaction has occurred between the parties.

## ZONING AND PERMITS

In Ontario, all development and use of property, including subdivision planning, as well as any construction that occurs on such property must comply with the zoning by-laws and official city plans of the municipality in which it is situated. Zoning by-laws are a method a municipality uses to control the use and type of development of the lands within its borders. The zoning by-law of a municipality will set out specific requirements that must be followed such as how certain property may be used, requirements for lot-size, frontage and setbacks, building heights, the number of parking spaces, the size of the back yard, etc. Passing and amending zoning by-laws requires compliance with the circulation and notice provisions contained in the Planning Act, and includes avenues for appeal if an amendment is rejected. Proposed changes to the zoning by-law that are minor in nature can be effected by way of a "minor variance". To obtain a minor variance an application must be made to the local committee of adjustment, which will follow certain prescribed circulation and notice procedures and hold a hearing on the variance request. If a structure is in violation of a zoning by-law but was built prior to its enactment it may be the case that such property has the designation of "legal non-conforming use". One must look to the by-law in question to determine the rights that property owners would acquire if a non-conforming structure predates the by-law's enactment. Building permits are also required before constructing, demolishing, altering, or changing the use of a building or structure. All construction in Ontario must comply with the Ontario Building Code Act which requires owners to obtain building permits prior to construction in order to ensure compliance with basic Building Code standards and other municipal requirements.

# Estudio Jurídico Otero

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Chile

📍 Avenida Apoquindo, piso 13,  
Las Condes Santiago, Chile,  
7550190

☎ +562 2361 8900

✉ gerardo@otero.cl

www.otero.cl

## General Information

Estudio Jurídico Otero was founded by Mr. José A. Otero B. in July 21st, 1923. From the return of Mr. Miguel Otero L. in 1957 from United States, after having received the Degree of Master in Comparative Law, the Firm started to develop its international practice, advising a vast variety of international and multinational companies in their businesses in Chile and also Chilean companies and customers doing business outside the country, in the United States and Europe, inclusively

Nowadays, we are a legal team with 90 years of history. We have been able to renew ourselves continuously, adapting us to the new requirements and technologies in the world of business and law, but maintaining our ideals, traditions and history.

## Main Areas of Practice

In Estudio Jurídico Otero we render integral legal advice, based on quality services and multiple experience of our lawyers.

Our professional services cover all legal aspects required in corporative and business activities, such as: Civil, Commercial, Corporate, Contracts, Financing, Mergers and Acquisitions, Foreign Investments, Energy, Environmental, Constitutional Law, Administrative Law, Antitrust and Trade Regulations, Consumer Law, Privatization, Infrastructure and Real States, Water and Sanitary Services, Labor and Employment Law, Tax Law, Telecommunications, Information Technology, Intellectual Property, Copyright, Technology Law, Internet and Cyberspace, Licensing, Privacy, Communication and Media, Commercial Arbitration and Litigation.

We also have extensive and proven experience in litigation of various kinds (including regulated markets), both in arbitration as regular and special courts, Courts of Appeal and Supreme Court.

## Membership

In Estudio Jurídico Otero Ltda. we are members of ILP Global (International Lawyer Partners), an association that is currently formed by law firms from Chile, Ecuador, Mexico, Perú and Spain, sharing and maintaining a common philosophy, project and working methodology. The Association seeks without losing the identity, idiosyncrasy and features of members' legislations, complying with clients' needs under different jurisdictions and working under a uniform criteria and procedures.

Additionally, our firm is member of E-Iure ([www.e-iure.com](http://www.e-iure.com)) a network of international practice law firms. Currently, it has members in 17 countries around the world, mainly from Europe and Latin America.

Chile has specific comparative advantages that make it the best place for foreign corporations to develop new business and expand their operations and sales in Latin America. Key among them is a stable and transparent legal framework for foreign investment, characterized by clear, non-discriminatory and non-discretionary rules. These principles are embodied both in the 1980 Political Constitution and in all laws, including the Direct Foreign Investment Law, known as Law 20.848. All the rights guaranteed by Chile's legal framework are further protected by Bilateral Investment Treaties (BITs). Up to this date, Chile has signed 52 BITs, 39 of which are in force at the time. In addition, Chile's Free Trade Agreements (FTAs) with Canada, Mexico, South Korea, China, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the United States include specific chapters on investment-related issues, including dispute-settlement mechanisms that are similar to those used in BITs.

Since May 7, 2010, Chile became a member of the Organization for Economic Cooperation and Development (OECD), an international cooperation organization of 34 states, which aims to coordinate their economic and social policies. It is considered that the OECD brings together the most advanced and developed countries in the world, for its members represent 70% of the global market.

According to the Central Bank of Chile, between 2009 and 2014 \$122,000 million entered the country under the concept of direct foreign investment. The five major investors of the period were United States with US\$ 24.895 million (20.4% of the total), Netherlands with US\$ 18.386 million (15.1%), Spain with US\$ 11.935 million (9.8%), Canada with \$5,401 million (4.4%) and United Kingdom \$6.016 million (4.9%). The mechanisms that can be used by foreign investors to enter Chile are; law 20.848, on foreign direct investment and chapter XIV of the Central Bank Compendium of rules about foreign exchange. Until January 1 2016, foreign investment entered the country using Decree Law 600, which has been repealed.

Based on constitutional principles, law 20.848, points out that foreign investors will hold the common legal regime applicable to domestic investors, without the possibility of arbitrary discrimination towards them, both directly or indirectly, thus ensuring the non-discriminatory treatment and limiting the discretionality of the administrative authority towards foreign investors. The non-discrimination treatment assures all people, regardless of their nationality, "to be treated by the State and its bodies in economic matters without arbitrary discrimination". Therefore, foreign investors enjoy the same rights and guarantees as local investors. The principle of non-discretionary treatment governs the activities in every economic sector and entails the existence of clear, well-known and transparent rules, which assure foreign investors they will be treated fairly and impartially.



## MAIN FOREIGN INVESTORS' RIGHTS

Foreign investors in Chile can own up to 100% of a Chilean-based company, and there is no time limit on property rights. They also have access to all productive activities and sectors of the economy, except for a few restrictions in areas such as the fishing sector, air transport and mass media. In the case of fishing, restrictions are subject to the rules of international reciprocity.

The State has a very minor productive role in Chile. Only a few strategic activities – such as exploration and exploitation of lithium, liquid and gaseous hydrocarbons deposits in coastal waters under national jurisdiction or located in areas classified as important to national security, and the production of nuclear energy – are restricted to the State. However, under certain circumstances, foreign companies can invest even in these sectors.

Law 20.848 guarantees foreign investors the right to repatriate the capital transferred at any time and to the remission of profits that their investments generate, once fulfilled all tax obligations that apply according to national rules. Additionally, it guarantees the right to access the formal exchange market to liquidate the currencies constituent of its investment and to get the foreign exchange necessary to remit the capital invested or the utilities obtained corresponding to its investment, all of the above with the exchange rate that parts involved freely agree. In addition foreign investors are granted an exemption from the sales and services tax in the import of certain capital goods which will later be specified. The repatriation of all invested capital is exempt from tax, assessment or charge relative to the original amount of the investment. Only the profits of capital over that amount are subject to the rules contained in the law of Tax on Income and the Tax code.

## FOREIGN INVESTMENT PROMOTION

With the new foreign investment law it was established a promotion of foreign investment strategy, which aims to position Chile as a center of business and international investment and a global platform to access other markets. Some axis of this strategy are:

- a. Facilitation of collaboration between foreigners investors and national companies for the development and expansion of productive activities.
- b. Promotion and facilitation of foreign investment economic and business activities in Chile.
- c. The creation of a Committee of Ministers for the development and promotion of foreign investment.
- d. The creation of an agency for foreign investment promotion, InvestChile, which main task is to promote and attract the entry of capitals and investments from abroad and provide guidance and information to potential foreign investors about the market, the legislation and the incentives applicable to their investment, as well as inform them of other aspects relevant to their investment, collaborate with foreign investors in the generation of contacts and meetings with government entities business associations, employers, suppliers, financial institutions, research centers and other actors who facilitate the entry of foreign investment to Chile.

## ADVANTAGES FOR FOREIGN INVESTORS

Although the Chilean constitutional regime is based in the principle of non-discrimination, law 20.848 offers certain tax advantages for foreigners investors. One of them is the exemption of the sales and services tax on the import of capital goods intended for the development, exploration or exploitation in Chile's of mining, industrial, forestry, energy, infrastructure or telecommunications projects, and technological, medical, or scientific research and development that involve investments by an amount equal to or exceeding five million dollars of the United States of North America.

This exemption is valid after, at least twelve months as from the internment to the country or acquisition in Chile of the first capital assets whose value added tax exemption is requested. For the granting of this exemption, the investor must submit an application to the Ministry of finance together with the certificate of foreign investor issued by the Foreign Investment Promotion Agency.

## TAXATION

All Chilean companies must pay the First Category Tax which has two taxation systems: semi integrated and attributed income. The tax rate will depend on the system of taxation to which the company decides to submit to, if it's attributed income the tax rate is 25% and if it is the semi integrated system, the tax rate is 27%. There is also tax rate of 35% for the distribution and remittance of profits abroad with the right to use as a credit to the consignment, the first category tax paid. This subject is explained in detail in the section about conducting business in Chile.

## FOREIGN INVESTMENT PROCEDURE

For purposes of application of law 20.848, is considered foreign investor any natural or legal person constituted abroad, non-resident or non-domiciled in Chile, that transfers to Chile, foreign capitals owned by a foreign investor or controlled by him, by an amount equal to or exceeding five million dollars of the United States of America or its equivalent in other currencies, that takes place through freely convertible foreign currency, physical goods in all its forms, reinvestment of profits, capitalization of credits, technology in its various forms that may be capitalized, or credits associated with foreign investment coming from related companies.

Under the mechanism of law 20.848, the investors should request a certificate issued by the Agency of Foreign Investment Promotion, which purpose is to enable the access to the benefits regime established for foreign investors. The application that the foreign investors submit for these purposes must certify the realization of the investment in the country, as well as contain a detailed description of the same, including their amount, fate and nature, all in the form and conditions determined by the Agency.

## **ABOUT DECREE LAW 600**

Until January 1 2016 remained in effect in Chile the Statute for foreign investment, known as Decree Law 600 (D.L. 600), through which most of the foreign investment entered Chile. Despite its repeal, a period of transition was established, during which it is possible to continue to sign contracts for foreign investment under the protection of the Decree for 4 years more, until 2020.

The mechanism of Decree Law 600 is that the investors held a contract with the State of Chile, this contract couldn't be altered unilaterally or by subsequent legal amendments.

Although the Chilean constitutional regime is based on the principle of non-discrimination, the D.L. 600 offered certain tax advantages to foreign investors. These were not tax exemptions, they intended to give foreign investors a stable tax horizon, allowing investors to set the existing tax regime at the moment that they make the investment.

According to the D.L. 600, a foreign investor could elect to set a tax rate income 44,45% for ten years. This way, the investor acquires some immunity from the tax increases that may occur during that period.

Foreign investors wishing to invest through the D.L. 600 must submit an application to the Promotion of Foreign Investment Agency, the minimum amount of investment for a new project is US \$5 million when the investment consists of foreign currency and associated credits.

Foreigners investors which had signed contracts prior to January 1 2016 kept entirely their rights and obligations referred in such contracts, equal protection shall enjoy the contracts subscribed in the transient term of 4 years.

## **NEW LEGISLATION FOR MINING PROJECTS**

On 16 June, 2005, Law 20.026 was published in the Official Gazette. It establishes a specific tax on mining activities.

According to this law, is considered mining operator, any natural or legal person who extracts minerals of concessionary character and sells them in any productive state in that they are.

This specific tax rate is progressive and is calculated according to annual sales and its equivalent value in metric tons of copper.

## ADDITIONAL INFORMATION

Most investment projects require additional permits and/or must fulfill other requirements besides those set forth in law 20.848. All investment projects, both local and foreign, must comply with the country's local and sector-specific legislation, at the national, regional and municipal levels.

It is worth noting that, besides the approval of InvestChile, some projects require additional information or authorization, which must be obtained from other competent authorities. Only as an example, we can mention that when an application for investments in the mining sector is presented the Foreigner Promotion Investment Agency asks the Chilean Commission of Copper (Cochilco) to issue a report on the project; the Fishing Superintendence reports on activities in that sector; the Banks and Financial Institutions Superintendence must authorize operations in the financial banking area; and the Securities and Exchange Commission reports on activities in the insurance and investment funds fields.

A concession granted by the Telecommunications Superintendence is required in order to install, operate and run public telecommunication services; intermediate telecommunication services through physical facilities and networks designed for this purpose; and radio sound broadcasting services. Complementary services, such as telephone banking or financial data over the telephone, do not require a concession or permit, although a technical ruling is required when equipment is connected to public telecommunications networks.

In the case of the environmental assessment of projects, it is based on the Environmental Assessment Service. Its main function is to introduce the use of modern technology and manage the environmental management tool called "System of Environmental Impact Assessment" (SEIA), which is based upon the environmental assessment of projects adjusted as provided in the existing standard, promoting and facilitating citizen participation in the evaluation of projects.

The role of this Service is to standardize the criteria, requirements, conditions, background information, certificates, procedures, and technical requirements of an environmental nature established by relevant ministries and other state entities, by establishing processing guidelines.

The modernization of the system aims to establish common criteria to evaluate each type of project, thus ensuring the protection of the environment in an efficient and effective manner.

In line with its commitment to free-market economic policies and free trade, Chile does not use tax incentives to support productive activities or to attract new investment. However, it does provide certain inducements for investments in some isolated geographic regions and new industries, particularly those in the technology field.

Investors can, for example, tap into government schemes to promote workplace training and to increase industrial productivity. All these schemes, in the form of grants and tax rebates, are available equally to both local and foreign investors and are part of a wider government strategy designed to increase competitiveness by extending the benefits of economic growth to all areas of the country, promoting education and training and encouraging technological innovation.

## **BILATERAL INVESTMENT TREATIES**

In 1991, Chile became a signatory of the Washington Convention of 1965 that created the International Center for Settlement of Investment Disputes (ICSID). Since then, the country began to negotiate Bilateral Investment Treaties (BITs), a mechanism through which Chile provides additional protection both to inward and outward foreign investment flows. As of November 2005, Chile had negotiated 52 BITs, 39 of which were in force at that time.

In these agreements, each Contracting State commits itself to provide fair and equitable treatment to investments legally materialized in its territory by investors of the other Contracting State. They also guarantee the principles of National Treatment and Most Favored Nation status.

Moreover, BITs protect private property rights through the establishment of basic principles and minimum standards in case of expropriations. Likewise, they guarantee that any expropriation or measure with similar effect will be adopted in accordance with a law based on public good or national interest, in a non-discriminatory manner. They state that expropriatory measures must be accompanied by the provisions of prompt, adequate and effective compensation.

Through BITs, the Contracting States guarantee the free transfer of capital, of profits or interest generated by foreign investments, and, in general any transfer of funds related to investments. Some restrictions may apply, in accordance with national laws.

Additionally, these agreements establish a dispute settlement mechanism in case of disputes that might arise between an investor of a Contracting State and the other Contracting State. Basically, this mechanism assures that controversies will be settled through friendly consultations. If no agreement is reached, the investor will be entitled to submit, at his own decision, the case before the domestic jurisdiction of the host State of the investment or to international arbitration. In most BITs, this jurisdictional option is definitive.

The principle of subrogation is also included in BITs. This means that if one Contracting State - or an agency authorized by it - grants any kind of insurance against non-commercial risks to an investment in the territory of the other Contracting

State, the latter shall recognize the rights of the former to subrogate for the rights of the investor in case it has paid the insurance.

The protection provided by these agreements applies both to investments made after the agreement comes into force as well as to those made before that date. These BITs, however, do not apply to disputes which arise prior to their entry into force or to disputes directly related to events which occurred prior to their entry into force.

Signed treaties need to be ratified by Congress before they can be in force. Treaties are in force in Chile once they are published in the Official Gazette (the Government's Official Registry of laws and decrees).

#### ► List of Investment Treaties

##### *Americas*

Country	Signed on	Status*
Argentina	August 2, 1991	In Force since February 27, 1995
Bolivia	September 22, 1994	In Force since July 21, 1999
Brazil	March 22, 1994	Not in force
Colombia	January 22, 2000	Not in force
Costa Rica	July 11, 1996	In Force since July 8, 2000
Cuba	January 10, 1996	In Force since September 30, 2000
Ecuador	October 23, 1993	In Force since February 21, 1996
El Salvador	November 8, 1996	In Force since November 18, 1999
Dominican Republic	November 28, 2000	Not in force
Guatemala	November 8, 1996	In Force since December 10, 2001
Honduras	November 11, 1996	In Force since January 10, 2002
Nicaragua	November 8, 1996	In Force since January 10, 2001
Panama	November 8, 1996	In Force since December 21, 1999
Paraguay	August 7, 1995	In Force since September 16, 1997
Peru	February 2, 2000	In Force since August 11, 2001
Uruguay	October 26, 1995	In Force since April 22, 1999
Venezuela	April 2, 1993	In Force since May 17, 1994

##### *Africa*

Country	Signed on	Status*
South Africa	November 12, 1998	Not in force
Egypt	August 5, 1999	Not in force
Tunisia	October 23, 1998	Not in force

\*State, the latter shall recognize the rights of the former to subrogate for the rights of the investor in case it has paid the insurance. The protection provided by these agreements applies both to investments made after the agreement comes into force as well as to those made before that date. These BITs, however, do not apply to disputes which arise prior to their entry into force or to disputes directly related to events which occurred prior to their entry into force. Signed treaties need to be ratified by Congress before they can be in force. Treaties are in force in Chile once they are published in the Official Gazette (the Government's Official Registry of laws and decrees).

*Asia, Pacific Islands and the Middle East*

<b>Country</b>	<b>Signed on</b>	<b>Status*</b>
Australia	July 9, 1996	In Force since November 18, 1999
China	March 23, 1994	In Force since October 14, 1995
Indonesia	April 7, 1999	Not in force
Lebanon	October 13, 1999	Not in force
Malaysia	November 11, 1992	In Force since August 4, 1995
New Zealand	July 22, 1999	Not in force
Philippines	November 20, 1995	In Force since November 6, 1997
Vietnam	September 16, 1999	Not in force

*Europe*

<b>Country</b>	<b>Signed on</b>	<b>Status*</b>
Austria	September 8, 1997	In Force since November 17, 2000
Belgium	July 15, 1992	In Force since August 5, 1999
Croatia	November 28, 1994	In Force since July 31, 1996
Czech Republic	April 24, 1995	In Force since December 2, 1996
Denmark	May 28, 1993	In Force since December 30, 1995
Finland	May 27, 1993	In Force since June 14, 1996
France	July 14, 1992	In Force since December 5, 1994
Germany	October 21, 1991	In Force since June 18, 1999
Greece	July 10, 1996	In Force since March 7, 2003
Hungary	March 10, 1997	Not in force
Iceland	June 26, 2003	In Force since May 16, 2006
Italy	March 8, 1993	In Force since June 23, 1995
The Netherlands	November 30, 1998	Not in force
Norway	June 1, 1993	In Force since November 4, 1994
Poland	July 5, 1995	In Force since September 22, 2000
Portugal	April 28, 1995	In Force since February 24, 1998
Romania	July 4, 1995	In Force since August 27, 1997
Spain	October 10, 1991	In Force since April 27, 1994
Sweden	May 24, 1993	In Force since February 13, 1996
Swiss	September 24, 1999	In Force since August 22, 2002
Turkey	August 21, 1998	Not in force
Ukraine	October 30, 1995	In Force since August 29, 1997
United Kingdom	January 8 1996	In Force since June 23, 1997

► **List of Free Trade Agreements***Americas*

<b>Agreement</b>	<b>Country</b>	<b>Signed on</b>	<b>Date of entry into force</b>
Canada-Chile FTA	Canada	December 5, 1996	July 5, 1997
Chile-Mexico FTA	Mexico	April 17, 1998	August 1, 1999
Chile-Central America FTA	Costa Rica	October 18, 1999	February 14, 2002 (Bilateral Protocol)
	El Salvador		June 3, 2002 (Bilateral Protocol)
	Guatemala <sup>1</sup>		August 5, 2010 (Bilateral Protocol)
	Honduras		August 28, 2008
	Nicaragua <sup>2</sup>		Bilateral protocol under negotiation
Chile-EU[3] EPA	European Union	November 8, 2002	February 1, 2003
Chile-US FTA	United States	June 6, 2003	January 1, 2004
Chile-Korea FTA	South Korea	February 15, 2003	April 1, 2004
EFTA	Iceland	June 26, 2003	December 1, 2004
	Liechtenstein		
	Norway		
	Switzerland		
	Chile-China FTA	China	November 18, 2005
Pacific-4 (P-4)	Brunei	July 18, 2005	November 8, 2006
	New Zealand		
	Singapore		
Chile-Panama FTA	Panama	June 27, 2006	March 7, 2008
Chile-Colombia FTA	Colombia	November 27, 2006	May 8, 2009
Chile-Peru FTA	Peru	August 22, 2006	January 1, 2009
Chile-Japan EPA	Japan	March 27, 2007	September 3, 2007
Australia-Chile FTA	Australia	June 30, 2008	March 6, 2009
Chile-Turkey FTA	Turkey	June 14, 2009	March 1, 2011
TLC Chile-Malaysia	Malaysia	November 15, 2010	April 18, 2012
TLC Chile-Vietnam	Vietnam	November 11, 2011	February 4, 2014
TLC Chile-Thailand	Thailand	October 4, 2013	November 5, 2015
Protocolo Comercial Alianza del Pacífico	Alianza del Pacífico	February 10, 2014	May 1, 2016

► **Agreements Under Negotiation***Indonesia*► **Double Taxation Agreements**

*Chile has double taxation treaties in force with several countries and a few to be eventually signed.*

**i. Treaties in force**

- |                               |                               |                               |
|-------------------------------|-------------------------------|-------------------------------|
| • Australia, February 8, 2013 | • Canada, February 8, 2000    | • España, 24 de Enero de 2004 |
| • Austria, December 6, 2012   | • Colombia, December 22, 2009 | • France, September 14, 2006  |
| • Belgium, July 17, 2010      | • Croatia, June 24, 2003      | • Ireland, October 28, 2008   |
| • Brazil, October 24, 2003    | • Denmark, February 10, 2005  | • Malaysia, October 2, 2008   |
|                               | • Ecuador, October 24, 2003   | • Mexico, February 8 2000     |



- New Zealand, September 4, 2006
- Norway, October 20, 2003
- Paraguay, October 2, 2008
- Peru, January 5, 2004
- Poland, March 27, 2004
- Portugal, October 28, 2008
- Rusia, January 1st, 2013
- South Korea, October 20, 2003
- Spain, January 24, 2004
- Sweden
- Switzerland, August 6, 2010
- Thailand, August 9, 2010
- United Kingdom, February 16, 2005

**ii. Subscribed Agreements**

- United States
- South Africa
- Uruguay
- Argentina, 15 de mayo de 2015
- China
- Italy
- Japan
- Czech Republic

► **Economic Complementation Agreements**

- Bolivia, April 6, 1993
- Cuba, June 27, 2008
- Ecuador, January 25, 2010
- MERCOSUR, October 1, 1996
- Perú, March 1, 2009
- Venezuela, July 1, 1993

► **International Transport Agreements**

- Argentina (air and sea), January 25, 1949
- Germany (air and sea), September 11, 1978,
- United States of America (air), February 4, 1994,
- France (air), July 21, 1978,
- Panama (air), April 25, 2001,
- Singapore (sea), November 25, 1993,
- Switzerland (air), November 18, 2009,
- Uruguay (air), February 27, 1995,
- Venezuela (air and sea), April 18, 1994.

**ABOUT CONDUCTING BUSINESS IN CHILE**

In general terms, business in Chile are conducted and formalized through a company that usually is organized as a Limited Liability Company, a Simplified Joint Stock Company (SpA) or as a Corporation all of which can be a subsidiary of a foreign entity, or through the incorporation of a Branch of a foreign corporation in Chile.

Chilean Law requires that only some and specific kind of businesses are conducted through corporations, such as banks, mutual funds and insurances companies.

Among the types of business entities, please be aware that the Branch of a foreign entity presents a major difference to the other type of entities, as the incorporation of a Branch is formalized through the designation of an Agent who shall be

empowered with broad managing and representation powers of attorney, and the foreign parent company is fully liable for the activities of its Chilean Branch. Its liability is not limited to the capital allocated to the Branch in Chile and, moreover, the local IRS is empowered to assess the branch's taxable income if it considers that the accounting records are not appropriately reflecting that income. Moreover, although the Chilean Branch of a foreign company can deduct specific expenses incurred by the foreign parent company in connection with the Branch's activities that are necessary to produce the local Branch's income, there are some IRS rulings that state that payments made abroad to cover such expenses are subject to a 35% withholding tax. General unspecified charges are not deductible.

#### ► Types of companies most commonly used in Chile

- **Limited Liability Company**  
They can be formed by at least two natural or legal, national or foreign people who limit their liability to the amount of the contributions made and there isn't a minimum capital set. The object, management and control of the society can be freely agreed by the partners.
- **Corporation**  
It is a society formed by the meeting of a joint fund provided by two or more shareholders responsible only for their respective contributions and administered by a Board of Directors composed of at least three members.
- **Simplified Joint Stock Company**  
This is a simplified version of a Corporation. It is a legal entity created by one or more persons by means of an act of Constitution, whose participation in the capital is represented by shares. Additionally, the SpA is governed by the rules applicable to the Corporations. The main feature of this society is the possibility of having a single shareholder, with the capital divided into shares.

#### ► Similarities between the Simplified Joint Stock Company, Limited Liability and Corporations

*The main similarities between the Simplified Joint Stock Company, Limited Liability Company and the Corporation are the following:*

##### i. Incorporation

Simplified Joint Stock Companies, Limited Liability Companies and Corporations are incorporated through the granting of public deed, the publication of a summary of it in the official journal, and its registration in the Trade Registration of the Real Estate Conservative. The relevant statutes should be included in the public deed of incorporation.

The company formation process takes a time of approximately two to three weeks from the date from which the powers are granted to be able to represent foreign partners or shareholders.

##### ii. Liability

Companies are liable up to the amount of the capital established in the bylaws. Furthermore, partners and shareholders are responsible only up to the amount of the contributions made and committed.

##### iii. Control

Neither of these companies are subject to specific control by any government agency, except for the authority of local IRS. The only exception are Public Limited Companies which are subject to the supervision of the Superintendence.

**iv. Taxation**

In September 29, 2014, a tax law reform was published, which modified the income taxation system and introduced other settings to the tax system. This new system is progressively entering into force, in order to be fully applicable in the year 2018.

The same tax structure applies for Simplified Joint Stock Companies, Limited Liability Companies and Corporations, which we can divide in two stages: the first stage, when generating utility; and the second, dividend distribution to the shareholders or partners.

In first stage, the applicable rate will depend on the taxation system a company decides to submit, the attributed income regime has a tax rate of 25% and the semi integrated (or partially integrated) regime has a 27% tax rate. However, the possibility of choosing between systems will be determined by the type of legal entity and by its composition.

Simplified Joint Stock Companies and Limited Liability Companies can select the Attributed Income tax regime, when formed exclusively by natural persons either with or without residence or domicile in Chile and when formed by legal entities without domicile or residence in Chile.

The default system for Simplified Joint Stock Companies and for Limited Liability Companies that do not exercise its right to choose, is the partially integrated regime.

In consideration to the Semi Integrated regime, all First Category taxpayers are able to choose this regime, without any further requirements. Additionally, Companies in which any of their shareholders or partners are legal entities with domicile or residence in Chile and Corporations, are required and obliged to partake in this regime.

Taxpayers must remain at least five commercial years in the elected tax regime, only being able to change after that time lapse, in addition to complying with the aforementioned requirements.

In second stage, you must pay for the income generated to partners or shareholders because of the company's profits. The rate of this personal income tax will vary according to the Tax Regime under which the company operates.

For the payment in the second stage, a tax credit is granted because of taxes paid in the first stage.

In the event of the company operating under the Attributed Income Tax Regime, the rate of the personal tax for the partners or shareholders will be of maximum 35% on earnings, and they will be able to use 100% of the tax paid by the company as a credit.

***In the event of the company operating under the Semi Integrated Regime:***

- a. The personal tax rate for partners or shareholders residents in Chile will be progressive, of 0% to 44,45% on earnings.
- b. The personal tax rate for the shareholders or partners residents in countries with which Chile has subscribed an Agreement to Avoid Double Taxation, will be of maximum 35% on earnings.
- c. The personal tax rate for the shareholders or partners resident in countries with which Chile has not subscribed an Agreement to Avoid Double Taxation, will be of maximum 44,45% on earnings.

► **Differences between Simplified Joint Stock Company, Limited Liability and Corporations**

**i. Management**

- **Corporation:** A Board of Directors manages it and appoints the general manager (CEO) and other persons that are also representatives, all of whom are legal representatives of the corporation with the powers of attorney and limitations granted by the Board. Certain essential matters such as merger, termination, capital increases, the sale of all or the majority of corporation's assets as well as other relevant company matters, must be decided upon by the Shareholders in an Extraordinary Shareholders Meeting. The annual report and balance sheet must be approved by the Shareholders Meeting. The Board is elected by shareholders and it must be comprised of at least three members. The directors do not need to be domiciled in Chile and can be nationals or foreign. The corporation's bylaws can determine the existence of back up directors, in similar number as official Directors, all of which can be compensated or not.

The Directors have the right to be duly informed; their duties cannot be delegated and are exercised collectively in a special and specific meeting. In the exercise of their duties, Directors must use the concern that persons usually use for their own business, and will severally and jointly be liable for damages caused to the company or the shareholders through fraudulent and tortuous acts.

Board Meetings must be held in the place indicated in the summons or otherwise in the Corporate Bylaws and directors must assist in person. However, it is possible to authorize Board Meetings in which one or more directors are connected by phone or video conference.

- **Simplified Joint Stock Company:** The Administration regime will be established in the society bylaws. In case the bylaws don't stipulate the regime, the society will be submitted to the rules applicable to the Corporations.
- **Limited Liability Company:** They are managed by the partners or by whomever they appoint for such purposes in its bylaws or through specific powers of attorney granted in a different public deed. This representative will have the powers expressly granted to him.

Therefore, the management of a Limited Liability Company is simpler as it does not require shareholders and/or board meetings, unless management is stipulated to be through a Board of Directors, which is exceptional.

Nevertheless, if the manager has been appointed in the company's bylaws, his removal must be done by amending such bylaws, fulfilling the same requirements to incorporate the company (public deed which abstract must be registered and published).

## ii. Capital

The law does not require a minimum amount of capital but it must be enough to allow the business entity to finance start-up costs. In Limited Liability Companies, Simplified Joint Stock Companies and Corporations the capital can be contributed at incorporation or within the term agreed to in the bylaws but subject to a three year term and in accordance to company needs.

- **Corporation:** its capital is divided in shares. The initial capital must be subscribed and paid in the period of 3 years, otherwise the company's capital is reduced to the paid amount, except for bonds convertible into shares, all of the aforesaid pursuant to law. The law does not allow the shareholder to pay its stock with direct personal work for the corporation.
- **Simplified Joint Stock Company:** the society's capital must be set in an accurate way in the bylaws and will be divided in a determined number of nominative actions. Social capital and its subsequent increases should be fully committed and paid in the term indicated in the bylaws. If not specified otherwise by the bylaws, the term will be five years. If it is not committed in that period, the society's capital shall be reduced to the amount effectively subscribed and paid.
- **Limited Liability Company:** its capital is not divided into shares and the percentage ownership of the Company is represented by the percentage contribution to the company's capital. The initial capital must be paid in the period agreed in the bylaws.

## iii. Transfer of shares or rights

- **Stock Company and Corporation:** the procedure to transfer shares is simple and does not require significant formalities, it can be done through private deed signed before two witnesses or authorized by a Certifying Officer.
- **Limited Liability Company:** ownership interests cannot be freely assigned by one partner to another partner, this being a modification of the company's bylaws has to be formalized through a public deed unanimously agreed by all partners. The deed of incorporation must be amended and an abstract must be published in the Official Gazette and registered with the local Registry of Commerce.

#### iv. Profits

- **Corporation:** utilities may only be distributed if there are profits in the respective commercial year. Furthermore, profits may only be distributed in proportion to the number of shares owned by each shareholder. The law states that annually, at least 30% of the yearly profits must be distributed as dividends, unless the shareholders unanimously agree not to distribute.
- **Simplified Joint Stock Company:** the profits can only be distributed if there are utilities in the corresponding exercise. Otherwise it is subject to the statute stipulations and if there is nothing said in the Statute the rules of Limited Companies will be applied. The Statute may establish that society must pay a dividend on a fixed amount, determined or to be determined, to the stocks of a specific series.
- **Limited Liability Company:** if the partners agree, the benefits can be distributed in a different proportion from the participation in the society.

#### v. Unique Tax on non-deductible expenses

In **Corporations, Simplified Joint Stock Company and Limited Liability Companies** Certain transactions, such as non-deductible expenses, presumed withdrawals corresponding to utilization of the company's fixed assets and loans of the company to its shareholders who are natural persons are subject to a unique tax.

The determination of the tax will depend on the possibility to attribute to any of them owners of the company a benefit by the rejected expenditure, if the expenditure is attributed to the company the tax rate will be of 35%, in the event that is attributed to a shareholder or partner will be of 10% additional to the progressive personal income tax or in the case of shareholder or non-resident partners in Chile, to the withholding tax.

#### vi. Duration

- **Corporations and Simplified Joint Stock Company:** the duration may be indefinite.
- **Limited Liability Company:** the term may not be indefinite. Nevertheless, the partners may incorporate it for the period of time they agree to, with no legal limit, and it may be automatically extended.

#### vii. Amendments

- **Corporations:** amendments to the by-laws must be approved through an Extraordinary Shareholders Agreement and depending on the nature of the agreement, different voting majorities may be required.
- **Simplified Joint Stock Company:** the stipulations of the social Statute can be modified by a shareholders meeting agreement, which shall be recorded in a minute that should be legalized and made public deed. No meeting shall be required if all of the shareholders sign a public deed or private protocolized document evidencing the modification. A summary of the modification document must be registered and published.
- **Corporations:** amendments to the by-laws must be approved through an Extraordinary Shareholders Agreement and depending on the nature of the agreement, different voting majorities may be required.

► **Similarities between the Simplified Joint Stock Company, Limited Liability and Corporations**

*It is important to highlight that Corporations cannot maintain or purchase their own shares except in very specific cases only regarding publicly traded companies, and the transaction must be approved by 2/3 of the shareholders.*

*The Simplified Joint Stock Companies that for more than 90 days in a row has 500 or more shareholders or, at least, 10% of its subscribed capital belongs to a minimum of 100 shareholders, will be transformed into a Limited Company.*

*The Simplified Joint Stock Company may acquire and own shares of its own emission, with the exception that it is prohibited by the bylaws and these shares must be disposed of within the term set in the bylaws, otherwise must be disposed of in the term of a year counting since their acquisition.*

*Any national or foreign natural or legal person intending to develop an economic activity in Chile, should get a Tax Number (RUT) granted by the Tax Service. This procedure must be performed by: legal persons or individuals not resident in Chile that will invest in the country; Natural persons or legal entities not resident or domiciled in Chile involved in societies as partners or shareholders; and persons not resident or domiciled in Chile that intend to develop agencies, branches or permanent establishments in the country.*

*All Chilean Companies and legal or natural foreign persons, that plans to invest in Chile, must appoint a legal representative who is a Chilean resident, which will act on its behalf to the administration of the Republic of Chile.*

*It is not necessary that the directors or managers of the company are neither Chilean nor residents.*

► **Similarities between the Simplified Joint Stock Company, Limited Liability and Corporations**

*See above. Conducting Business in Chile – Taxation.*

# Chile | LABOUR & EMPLOYMENT LAW

The Chilean Constitution (article 19 N° 16) recognizes and protects the freedom to work. It stipulates that every person has the right to choose his/her job and to a fair salary. It also forbids any form of discrimination not based strictly on capacity or personal ability to perform a service. It also establishes the freedom to form unions, the right to social security and the prohibition on conditioning recruitment or job-permanence to a particular affiliation or union membership or other forms of organization (or non-membership to such organizations) and ensures the collective bargaining rights of all workers.

Labor laws in Chile are basically contained in the Labor Code, notwithstanding other regulations such as, in ex. Act number 16.744 regarding labor accidents. The Labor Code regulates labor relations between employers and employees and, although it is a private law regulation, it contemplates private public law which cannot be waived by the parties, especially for the employee.

Except in the case of matters not regulated by special laws or if a rule specifically states it, the Labor Code does not apply to people working for the State (whether centralized or decentralized agencies), for the Legislature or the Judiciary, or to any public employees subject to special rules (but only to the extent of those special rules).

The rights contained in the labor laws cannot be waived while the employment contract remains in force. Thus, each employee enjoys certain minimum inalienable rights, and any attempt to cause an employee to waive such rights is unenforceable. Notwithstanding of the aforesaid waive prohibition, these rights can be complemented by the additional rights and benefits granted by the employer in the work contract, its annexes or subsequent amendments.

The general principles contained in the Labor Code state that employment has a social function and every person has the freedom to contract and engage in the lawful employment he/she chooses.

The Labor Code defines the subjects of labor relations, which are the employer and the employee. It says that the employer is any natural or legal person who uses the intellectual or material services of one or more persons under an employment contract. The employee is any person who renders intellectual or material services as a dependant and subordinate under an employment contract.

As these definitions show, the basic aspects that determine whether a relationship is ruled by labor laws or is that of an independent contractor are subordination

and dependency. Therefore, it is important to be careful in drafting and negotiating contracts because although the parties may have agreed to be ruled by civil, common or commercial contractual relationships, since labor rights cannot be waived, a court may determine that it is in fact a work relationship and thus subject to the rights and obligations we will refer to herein.

## HIRING

### ► Discretionary termination vs. legal termination cause.

*Employment stability is a governing and one of the most important principles in Chilean Labor Law, hence most of the employment relationships are permanent, unless otherwise expressly stated in each labor contract and always with certain limitations.*

*As a consequence, the employment contract may be terminated only on any of the legal grounds set forth in articles 159, 160, 161 and 163 bis of the Labor Code and the employee shall be entitled to receive compensation per years of services, depending upon the reason for termination.*

*According to article 159, the employment contract can end by mutual agreement, by resignation of the employee, by the death of the employee, expiration of the term agreed in the contract, the conclusion of the task or work for which he/she was hired and by acts of God. In these cases, there is no severance payment and the employer must only pay the sums due to the worker in relation to employment until the date of termination of the work relationship.*

*Also, according to article 161 of the Labor Code, the employer may unilaterally terminate the contracts of executive and senior officers. Also, if other employees who are not executive and senior officers or employees of the employer's exclusive reliance can be unilaterally terminated invoking business needs (financial or other), which shall be duly and adequately justified and accredited by the employer and fully described in the respective letter of dismissal. The basic procedure for this kind of dismissal is as follows:*

- a. a formal written notice of the termination must be delivered to the employee not less than thirty days in advance of the effective date of termination, unless compensation is paid in lieu of such notice equivalent to the last monthly salary earned by the employee, with a maximum limit of UF 90.
- b. a compensation for years of service shall also be paid if the work contract has been in force for a year or more, equivalent to the last salary earned by the employee for each year of service or fraction over six months, with a ceiling of 330 days (11 years of service). The salary used in this calculation is limited by law to UF 90 monthly (90 Unidades de Fomento, an indexation unit, of approximately US\$ 3,950).



*The employer may choose to pay this compensation on the basis of salary actually paid to the worker in the event that this exceeds the limits established by law for the calculation.*

*Article 160 of the Labor Code provides grounds attributable to misconducts of the worker that can end the contract without the employer's obligation to pay compensation (only sums due to the worker in relation to employment until the date of termination of the work relationship), such as: lack of integrity in the performance of duties; sexual harassment behavior; physical aggression against the employer or other employees; insults against the employer; immoral behavior affecting the company; holding negotiations with employer's competitors prohibited by the employment contract; unjustified absences; untimely abandonment of duties; reckless acts or omissions affecting employee's safety, the company or other employees; material damage intentionally caused to the company and breach of the obligations under the contract.*

*Finally, article 163 bis of the Labor Code states that the labor contract terminate if the employer is subject to bankruptcy proceeding.*

*If the cause alleged by the employer in the formal letter of dismissal is considered unfair or inapplicable, the employee has 60 days to file a suit against his/her employer (notwithstanding administrative remedies with 90 days limitation) and the severance payment and sums due to him can be increased by 30% to 100% if the court sustains the employee's claim.*

*If the court deems that the dismissal was anti-union conduct, then the employee will choose between recover his job or be paid 6 to 11 monthly salaries, plus payments for unfair dismissal.*

*In any case, once the labor relationship is terminated a settlement agreement should be signed. Such labor settlement must be signed and ratified by the employee before a Notary Public or other Faith Minister, for which compliance certificate must be exhibited by the employer crediting that Social Security and health obligations had been duly paid by the employer during the labor relationship and compensations due to contract termination.*

*If the parties agree to pay in installments the resulting amounts for the worker corresponding to the settlement agreement, the payment must include interest and adjustments and the agreement cannot be authorized by a notary public, but by a Labor Inspector.*

## ► **Discrimination**

*The Chilean Constitution forbids any form of discrimination not based on capacity or personal adaptation.*

*Article 2 of the Labor Code states that any form of discrimination violates labor rules. Discrimination consists of arbitrary distinctions based on race, sex, color, age, marital status, union membership, religion, political ideas, nationality or social origin and transgresses the principles of labor laws. No employer can condition the hiring of an employee to those circumstances.*

*Nor can an employer condition the hiring of an employee to the absence of economic, financial, bank or commercial obligations unless the employee will have power of attorney to act on behalf of the employer that involves at least general managing powers; or he/she will be in charge of collecting, administrating or safekeeping funds or valuables of any nature.*

*Finally, it should be noted that the Labor Code provides a special procedure to protect workers from discriminatory conduct and any violation of their fundamental rights guaranteed by the Constitution - whether during the labor relationship or with occasion of the dismissal- which may result in the appliance of fines between 6 to 11 monthly salaries to the affected employee.*

### ► **Employment Applications**

*The above-mentioned rules must be taken into account in employment applications and interviews, particularly the rules relating to nondiscrimination.*

*In general, there are no express rules regarding convictions, but it is not considered illegal to request a certificate of criminal record for a potential employee.*

*Some positions require the exclusion of those individuals who have been convicted for crimes punishable by imprisonment of more than three years and one day.*

*Medical examinations may be required of applicants if a particular health condition is required in the position to be filled.*

### ► **Employment Contract**

*According to article 7 of the Labor Code, the individual employment contract is an agreement where the employer and employee are mutually obliged, the latter to render personal services as a dependant and subordinate, and the former to pay a salary for such services.*

*Article 8 also stipulates that any rendering of services under such circumstances makes the existence of an employment contract presumable. This legal presumption, which admits refutation, is one of the most important ones of our labor regulation.*

*Article 9 of the aforesaid Code states that the employment contract is a consensual one, but a written counterpart must be signed within 15 days after the employee started work or 5 days, if he was hired for a specific task, work or job that will take less than 30 days. The absence of a written contract shall mean that the terms and conditions are the ones declared by employee, and the employer will be subject to a fine.*

*Article 10 of the law specifically describes the basic information that the contract should contain, such as date and place of the contract, identification of the parties, including the employee's nationality and date of birth, nature of the job, place where it must be done, salary and payment terms, work day and term of the contract.*

### ► **Advertising/Recruitment**

*Any job offer made by any means, directly or through a third party, is considered in violation of labor rules if special discriminatory requirements are imposed regarding race, sex, color, age, marital status, union membership, religion, political ideas, nationality or social origin, unless it is related to the capacity of the people to perform their job.*

### ► **Employment references/Background investigations**

*There is no prohibition for employers to verify the references provided by a job applicant, being common practice to request for references and review of the same.*

## COMPENSATION AND BENEFITS

### ► Minimum wage

According to article 41 of the Code, wage or salary is any sum of money or kind appraisable in money that the employee receives for his work, excluding meal, transportation and travel allowances, family benefits and others. Article 42 states that it includes salary, overtime payments, commissions, and profit share.

The monthly salary that is agreed upon in the employment contract cannot be lower than the minimum salary established by law, which is updated yearly. The wages for part-time jobs cannot be lower than the minimum applicable (which is annually updated by law), calculated proportional to the normal workday.

A percentage of company's annual profits must be distributed among employees in one of the following ways:

- |   |  |
|---|--|
| a. 30% of net taxable profits, with certain adjustments | b. 25% of the annual salary, with a maximum of 4.75 minimum salaries per employee. The employer is free to decide which alternative to use every year. |
|---|--|

The parties may agree to additional benefits to be provided to the employee above the legal minimum, which may or may not be considered as some of the legal benefits mentioned above. Notwithstanding, any benefits received by the employee might be considered as acquired rights even if not written in the employment contract.

### ► Minimum age and Child labor

Anyone over 18 years olds can celebrate any kind of employment contract, without requiring authorization. However, the Labour Code authorizes exceptionally children under 18 and over 15 to enter into employment contracts only for rendering light services which does not harm their health and development.

These employment contracts present some differences with ordinary employment contract. Between the ages of 15 and 18, an employee needs his parents' authorization or, in their absence, their legal guardians that have taken over the child, to work (maximum of 30 hours per month) and he cannot work in cabarets or places where alcoholic beverages are sold nor work at night. Persons between the ages of 15 and 16 can work only if they have the above-mentioned authorization, after finishing schoolwork.

Only in duly qualified cases, with the permission of their respective legal representative or the Family Court, may be permitted to under fifteen who celebrate employment contract with persons or entities engaged in theater, film, radio, television, circus or other Similar activities.

### ► Salary payments

Shall be paid in Chilean currency. However, expatriate employees may be paid in foreign currency.

According to article 44 of the Code, the salary can be set according to units of time, days, two weeks or month, or by piece, unit or job. In any case, the unit of time cannot exceed one month.

### ► Health insurance and social security benefits

Employees must finance their retirement pension through the contribution of the 10,41% to the 11,48% of their monthly salary, which is to be retained by the employer. Men may retire at the age of 65 and women at the age of 60. Contributions are made to pension funds managed by private entities (AFP), subject to control by government superintendence.

Death and disability pensions are financed with retirement funds and insurance plans. These contributions are paid to the same pension fund to which retirement contributions are made.

Regarding health benefits, employees may choose between a public health system, financed by a contribution of 7% of the employee's salary, or a private system under which the employee affiliates to a private health insurance company (ISAPRE). The minimum contribution is similar to that of the public health system.

All these social security benefits are withheld by employers from employees' salary and paid to the corresponding entities. Such contributions are a tax deduction for employees and are calculated against a salary that is limited to 66 Unidades de Fomento (approx. US\$ 2,700). However, the employee can agree to deposit an amount above the legal limit.

Work accident and occupational disease benefits are financed by employers through a basic contribution equivalent to 0.95% of monthly salaries.

Expatriates who have a professional or technical degree may obtain a waiver of social security contributions, provided they are enrolled abroad in a social security system that provides benefits at least similar to those existing in Chile. The exemption does not include work accident insurance contributions. For said exemption to operate, they will need a certificate from the social security institution abroad and placing on record in the contract or an annex that they have chosen that option.

### ► Workday, work week and overtime

Article 22 of the Labor Code establishes a general maximum work week of 45 hours that cannot be divided into less than 5 or more than 6 days. The work day cannot exceed 10 hours. Special rules apply to special jobs such as crew on fishing ships that do not involve continuous work during the day, or drivers.

A maximum of two hours per day of overtime can be agreed, and that time must be paid with a 50% surcharge. The agreement must be in writing and for no longer than 3 months. The purpose must be solely to attend to temporary needs of the company, and may therefore not be contracted on a permanent basis.

Attendance and completion of work schedules and shifts must be controlled by means of a special book or clock.

The work day must be divided in two in order to allow at least 30 minutes for lunch. This time will not be considered time worked.

The above-mentioned time limit is not applicable to top levels of the organization, such as vice-presidents, managers, executives, administrators and others who render similar services or work without direct superior supervision. Also, salesmen employees who work outside the company premises can be excluded from Overtime payments.

## TIME OFF, VACATION LEAVES OF ABSENCE

### ► Days off

*Every Sunday and holiday must be a day off, except for activities for which there is special authorization to work on those days.*

*The work shift or work week can be divided up to include Sundays and holidays only for certain specific jobs. A shift can run for two continuous weeks only for jobs distant from urban areas.*

*The companies expressly authorized to work on Sundays and holidays must give the employee a day off in compensation for every Sunday and/ or holiday worked, but at least two days off in the respective month must be granted on Sunday. In case that more than one day off is accumulated in the same week, the parties can agree to payment of the days off that exceed one per week. Payment cannot be less than the overtime salary (50% surcharge).*

### ► Vacations

*Employees with more than one year in the company have the right to a paid holiday of fifteen working days per year. Ten of these days must be taken consecutively, and the remaining five as agreed by the parties. Vacations can be accumulated only for up to two consecutive years. The employer can only compensate vacation time by a cash payment when the work relationship ends.*

### ► Leaves of Absence

*In case of illness or accident, the employee is entitled to a paid leave for the period indicated in the corresponding medical certificate.*

*Pregnant women are entitled to six weeks of paid leave before delivery and 24 or 30 weeks of paid leave after. (see letter F, maternity protection).*

*In both cases, the employment contract remains in force, but the employer suspends payment of salary and the employee instead receives compensation from the health insurance company.*

*As a general rule, employees cannot be terminated while their leave of absence is in force.*

### ► Day care and child benefits

*If a child younger than 1 year needs attention at home due to a sickness of concern, the working mother or father has the right to request a special leave of absence, based on the corresponding medical certificate.*

*Any company employing more than 20 women of any age or marital status must have a special place where mothers can feed and leave their children younger than 2 years old. The company can instead pay the expenses of day care directly to the child care service chosen by the mother. Mothers breastfeeding their babies, have the right to use an hour of their work shift to feed them.*

### ► Occupational Health and Safety

*The Labor Code imposes upon the employer the obligation to observe health and safety standards in the workplace, to implant measures to prevent accidents, and others alike. Every company, establishment, job or economic unit, whether commercial or industrial, that has more than 10 employees, needs to adopt an Internal Rule Code of Order, Hygiene and Safety, that must set down the prohibitions and obligations imposed upon employees in regard to their jobs, permanence and life in the respective company or establishment.*

*In terms of implementation, Internal Rule Codes must be published for thirty days in two places of company premises, so as to give employees the opportunity to read it and make comments. After that, a copy of the Internal Rule Codes must be sent to the Health Minister and Labor Authority within five days from the date on which it has entered into force. In addition, the employer must provide the employees with a free copy of such document.*

*Every employer must also pay special work accident and occupational disease insurance for each employee. The amount of the payment depends on the risks associated with the job, and the basic rate is 0.95% of the salary.*

### ► Maternity Protection

*In Chile, the working woman is specially protected, by the mere fact of her motherhood, without requiring prior authorization or any other formality. The only requirement is that the employee must present a medical certificate attesting to the pregnancy and formalities associated with a medical license for the payment of leave periods that the law provides.*

*The maternity leave protects working women from the beginning of her pregnancy until one year after the expiration of the postnatal leave. This protection prevents the employer from terminating the employment contract during this period, except for certain causes and with the court previous approval.*

*There are also pre- natal and post- natal rest periods. The first one consists of a resting period prior to the birth, which lasts six weeks before the delivery. The doctor or matron in charge of the care of women determines the date of birth for possible effects of prenatal leave. The second leave (post- natal) consists of a rest period after the birth which lasts for 12 weeks.*

*Since October 2011, entered into force in Chile postnatal parental leave, which lasts for 12 weeks after the regular postnatal period (12 weeks) has ended, with a subsidy ceiling of 66 UF with gross. If the employee exercises the right of reinstatement for half a day, the postnatal parental is extended to 18 weeks from the completion of regular postnatal leave.*

*If both parents are employees either of them, at the option of the mother, could enjoy the post-natal parental leave, from its seventh week, for the number of weeks that the mother indicates. Therefore, postnatal parental permission may be entitled to the father, with a cap of 6 weeks if the mother chooses not to be reinstated half day, or for 12 weeks if she chooses to do so.*

## GROUNDS FOR TERMINATION

See Discretionary termination vs. legal termination cause.

## NATIONALITY AND FOREIGNERS EMPLOYEES

### ► Nationality

*If a company has more than 25 employees, 85% must be Chilean. If it has less than 25 employees, there is no limitation. The calculation of this percentage must consider all of the company's employees in the country and exclude technical specialists who cannot be replaced by Chilean personnel. An employee is considered Chilean if he/she has a Chilean spouse or children or is a widow or widower of a Chilean or has lived in the country for more than 5 years.*

### ► Foreigners Employees

*Chilean Immigration Laws state that tourists are forbidden from undertaking in Chile any paid activities without the corresponding permit, regardless of the place where they are effectively paid. Special working permit can be granted for foreigners hired to work temporarily in Chile, for thirty days, renewable.*

*In order to work for a longer term in Chile, foreigners require a visa subject to an employment contract, or a temporary residence permit if they have a business, personal service contract, etc. For such purposes, an application must be filed before the Department of Foreign Affairs and Immigration or at the Chilean Consulate.*

*The employee must register with the International Police and obtain a foreigner's identity card and a taxpayer identity card.*

## INTELLECTUAL PROPERTY/FAIR COMPETITION/NON-COMPETITION COVENANTS

### ► Intellectual Property

*Chilean copyright law (Law Number 17.336 on Intellectual Property) provides in its Article 8, second paragraph, that in the case of computer programs, their copyright holders will be the natural or legal persons whose employees have developed them in performing their regular duties, unless otherwise stipulated in writing.*

*It states furthermore in its third paragraph that with respect to computer programs developed on behalf of a third party, their copyrights will be deemed as assigned to said third party, unless otherwise stipulated in writing.*

*Other rules regarding intellectual property must be expressly agreed upon by the parties, respecting the rules of copyright and intellectual property (regulated by Chilean law N ° 17.336 on intellectual property and N ° 19.039 on industrial property). Rules on intellectual property law are also protected by penalizing conducts violating said rules in the Unfair Competition Law which protects competitors, consumers and, in general, any person whose legitimate interests are affected by an act of unfair competition (Law No. 20.169).*

### ► Non competition covenants / No solicitation of employees and customers

*There are no express rules regarding the issue, but such covenants are not expressly prohibited and are usually set down in employment contracts. Nevertheless, their enforcement may be limited by antitrust laws and constitutional rights that grant the freedom to work, according to the specific circumstances of each particular case. In any case, a request like this is valid only during the work relationship, as later on it may be deemed as a threat to freedom to work, unless there is some financial compensation during the term of this covenant.*

## PERSONNEL ADMINISTRATION

### ► Required postings

*Except for the cases mentioned in the paragraphs above and for the Internal Health, Hygiene and Safety Regulations, as a general rule the law does not require notices to the employees to be posted or published.*

### ► Personnel records

*The employer must keep folders with the data and information of his workers comprising employment documents such as employment contracts, receipts for payment of salaries and pension contributions, and vacations, among others. The law allows this kind of information to be kept by the employer on a centralized basis, off the Company's premises.*

### ► Meals and rest periods

*See workday, work week and overtime*

### ► Payment Upon Discharge or Resignation

*An employee whose employment is terminated must be paid all wages due and owing, including all accrued and unused vacation time, and legal compensations, as appropriate in each case. This must be done simultaneous to signature of the discharge.*

### ► Employment References

*As has been previously mentioned, there are no rules regarding this matter. Nevertheless, it is common practice to request and give employment references.*

### ► Recordkeeping

*Law No. 19,628 governs the treatment that public bodies and individuals give to personal data that are stored in registers or databases, whether electronic or not.*

*To process personal data, the individual should be authorized by:*

- |   |  |                       |
|---|--|-----------------------|
| <p>a. Law N° 19,628 (data issuing or collected from publicly available sources or processed by a public body)</p> | <p>a. If the owner of the data expressly agrees to it (expressly, informed and in writing)</p> | <p>a. Another law</p> |
|---|--|-----------------------|

*Likewise, the purpose of said treatment must be permitted by law, if the information is of a commercial, financial, banking or economic nature, or is included in listings stating only the activity, occupation, education, degrees, address and date of birth.*

*This authorization is not necessary if the company needs the data for internal reasons. However, the law requires employers to maintain secrecy of all information and worker's private data obtained during the employment relationship.*

*Bear in mind that an act is currently pending in Congress regarding protection of personal data, which among other things amends in which cases the consent of the employee is necessary to use such data. Besides, a new regulation regarding international transfer of personal data is to be included in the same act.*



## PRIVACY

Article 5 of the Labor Code expressly states that employers must exercise their rights within the limits established by the Constitution, specially observing the rights and respect for privacy of the workers.

### ► Drug testing

*Although the parties may agree in the Work Contract that the Employer may conduct procedures for alcohol and drugs prevention, it is usual and recommended that everything related to these matters is duly established in the Internal Health, Safety and Hygiene Regulations.*

*Although there are no specific laws on the subject, the labor authority (Labor Inspection) has determined that drug testing and alcohol consumption controls can only be carried out to the extent that they respect as territorial and temporal limits, the times the employee remains within the Company. Also, the employer must take care that these drug tests are conducted randomly (to avoid complaints of discrimination or harassment) and their results should be kept respecting the privacy of the employee. Therefore, the results of the tests carried out should be kept and treated as confidential information in accordance with the provisions of Act 19,628.*

*Consequently, the employer may not intervene in any conduct that may be considered as part of the worker's private life. Additionally, procedures to take drug and alcohol tests must be done respecting the dignity, privacy and honor of the worker and with impartiality, in terms of being applicable to all workers without distinction, or to part of them, randomly chosen.*

*The results of the controls must be kept and treated as confidential in accordance with the provisions of Law 19,628.*

### ► Off-duty conduct

*Employers may not discharge or discriminate against an employee for engaging in lawful conduct outside of the workplace or after the workday.*

*There are no specific rules regarding medical information, searches, lie detector tests, fingerprinting, surveillance and monitoring.*

## EMPLOYEE INJURIES / WORKER COMPENSATION

See Occupational Health and Safety

## UNEMPLOYMENT

Chile has an unemployment insurance system:

This insurance establishes benefits for employees who lose their job, and it is financed by the employee, by the employer and by the Government, depending on the duration and kind of contract. This law entered into effect October 1, 2002.

**► Applicability**

*This insurance is applicable to workers who meet the two requirements below:*

- |  |   |
|--|---|
| 1. He/she must be a worker under employment contract | 2. The worker must be subject to the Labor Code |
|--|---|

**► Employees excluded from the insurance**

*The insurance does not apply to the following types of employment:*

- |  |   |
|--|---|
| 1. Servants (working in a private residence)         | 3. Employees under 18 years of age                            |
| 2. Employees hired under an apprenticeship agreement | 4. Independent workers  |
|  | 5. Pensioners receiving a total disability or old age pension |

**► Reporting Obligation**

*The employer must communicate the commencement or termination of the employee's services to the Corporation Manager of the Unemployment Insurance within 15 days of the occurrence. A breach of this duty will be fined in the amount of 0.5 UF (US\$ 20 approximately).*

**COLLECTIVE LABOR RELATIONS AND COLLECTIVE BARGAINING**

The Labor Code recognizes the right of employees to form unions, which may in turn join federations, confederations and headquarters. The law has ruled in depth on all the requirements, benefits, etc. of these unions and strongly punishes anti-union practices within the company.

The Union has the right to negotiate common working, salary conditions and any matters of common interest with the employer, through regulated collective or informal negotiations. Also, represent the collective rights of its members, regardless of other obligations set forth in its bylaws and not prohibited by law.

According to the new rules recently in force, the frame of time required since the company's incorporation in order to allow its employees to collective bargaining will depend on its size. For micro and small companies it will be of eighteen months since incorporation, for mid-size it is twelve months and for big ones it is six months, and the collective agreements cannot last less than two not more than three years.

If the employer refuses to accept the collective bargaining agreement proposed by employees, they may invoke their constitutional right to strike. Both collective bargaining and the right to strike are ruled in depth in the Code.

An impasse in collective bargaining can be submitted to mediation or arbitration if the parties decide to do so in order to try to reach an agreement.

## IMMUNITY

For employees in special, exceptional or particular circumstances, such as health conditions, positions in the unions or maternity, the law considers a special immunity by which their employment contract cannot be terminated unless a court authorizes it. The dismissal does not take effect until the authorization is granted, unless the court authorizes a provisional separation during the trial. In this case, if the authorization is denied, the employee must be reincorporated to his job and he is entitled to receive salary for the time he was separated from his job.

The following employees enjoy this privilege:

- a. Women, from the time they become pregnant to one year after the maternity leave ends;
- b. Employees who participated in the creation of a union, from 10 days before the respective meeting until 30 days after it was held (it cannot last more than 30 days)
- c. Candidates to a position in the union, as of the time they report the date of the election to such election
- d. Members of the board of the union, from the time they are elected to six months after their position ends
- e. The employees' representative on the Hygiene and Safety Committee, upon election
- f. Employees in collective bargaining, from 10 days before the presentation of the collective contract proposal to 30 days after it was signed or until the parties are notified of the arbitral award

Employers must also maintain the job of any employees called to serve in the army, for the entire period of the recruitment to 1 month after they are discharged.

## SETTLEMENT (RESOLUTION) OF LABOR DISPUTES

The Labor Code establishes the Labour Courts are the only tribunals with jurisdiction to rule any dispute arising between employer and employee. The procedure generally establishes a written claim and rebuttal, a preliminary hearing in which is offered and the judge proposes conciliation bases; a trial hearing itself, in which the evidence is redere before the judge.

Chilean labor law establishes as the only remedies against a ruling a general annulment and ruling unification.

Labour disputes may not be submitted to arbitration, except in certain cases of collective bargaining, with certain limitations.

**LABOR HARASSMENT/ MOBBING**

In Chile, the image of labor harassment has been recently defined by law published on the official gazette on August 8 2012. Labor harassment or mobbing –a term known this type of aggression- is defined as any conduct that constitutes harassment or repeated aggression exercised by the employer or by one or more workers, against one or more other employees, by any means, and that results for those affected or their impairment, abuse or humiliation, or that threaten or harm their employment status or employment opportunities.

The fact that the employer incurs in mobbing behaviors entitles the employee to sue his constructive dismissal before the Courts of Justice.

# Michael Damianos & Co LLC

—  
Cyprus

## General Information

Michael Damianos & Co LLC is a Cyprus law firm based in Nicosia, Cyprus. The firm's practice is highly international with a strong corporate, banking, energy and private client focus.

The firm's founder is a Solicitor of the Supreme Court of England and Wales and a member of the Cyprus Bar Association. Before practicing in Cyprus, he qualified and worked as a solicitor at the London offices of two international law firms, where he was mainly involved in mergers and acquisitions (general), energy related mergers and acquisitions and energy related commercial and regulatory work.

The firm's objective and commitment is to provide best quality, practical and cost-effective advice/services to its clients and to rapidly respond to their instructions and needs. It has an expanding client base ranging from high-net-worth individuals through to a variety of corporate entities and multinational organizations (private/public company and funds) and despite the diversity of its clients, it recognizes that each client is unique with particular business concerns and needs and,

therefore, it exercises a personal commitment to all of its clients.

Although a full service Cyprus law firm, our main areas of practice are international (and local) mergers and acquisitions, general corporate advice (including corporate disputes), winding up of companies, capital markets, banking, energy, general commercial work, real estate, and immigration to Cyprus for non-EU high-net-worth individuals.

In addition to the firm's purely legal work, it also practices in the area of company formation and administration/corporate services. The firm incorporates Cyprus companies (along with companies in various other jurisdictions, mainly offshore) to suit its clients' needs and provides a complete range of fiduciary/corporate services to such companies (such as the provision of company secretarial services, registered office address, company directors, company nominee shareholders and bank account opening). The firm is also able to assist its clients to establish representative offices in Cyprus and, through its associated companies, provide tax substance in accordance to their needs.

## Main Areas of Practice

Banking  
Capital Markets  
Corporate/Insolvency  
Cyprus Citizenship/Residence Permits  
Cyprus International Trusts  
Dispute Resolution  
Energy/Commercial  
Employment Law  
Intellectual Property  
Private Client  
Real Estate  
Shipping

📍 Office 401, 42E Arch. Makariou III Avenue  
Nicosia, 1065  
CYPRUS

☎ (+357) 22021212

✉ info@damianoslaw.com

🌐 www.damianoslaw.com

Cyprus is an ideal international business centre for all kind of businesses and individuals. One should careful consider the structure of the relevant entity before proceeding with its incorporation. There are the following legal entities/ vehicles under Cyprus law:

## PRIVATE LIMITED COMPANY

The most common legal entity/vehicle for carrying out business in Cyprus is the private limited company and the main characteristics of such a company are the following:

- The company is an entity with a separate and distinct personality from its members and the liability of its members is limited to their share contribution.
- The minimum number of shareholders is one and the maximum number is fifty.
- Invitations to the public for acquiring shares or debentures are strictly prohibited.
- Issuance of bearer shares is prohibited.
- There is no minimum issued and paid up share capital for companies, but some share capital must exist.
- The Company must have a registered office in Cyprus.
- The Company must have a secretary, who may be local or foreign, natural or legal person. It is customary for compliance purposes for the secretary to be local.
- The minimum number of directors is one and there is no maximum number. Directors may be local or foreign, natural or legal persons. However, it is suggested that the majority of directors are Cypriot residents so as to ensure that the company is managed and controlled in Cyprus in order for the Company to be considered Cyprus resident for tax purposes and be able to benefit from relevant double tax treaties.
- Meetings of shareholders and board of directors may be held anywhere in the world, but for tax purposes it is advisable for, at least board meetings, to be held in Cyprus.
- The company must have a memorandum and articles of association prepared by a lawyer in Cyprus, which must be signed by the subscribers and filed with the Registrar of Companies in Cyprus.
- The company's articles of association must provide for some restrictions for transferring shares.

## PUBLIC LIMITED COMPANY

This is a more regulated type of entity and it is usually used either when the company has a large number of shareholders or when it has to be listed in a stock exchange in Cyprus or abroad. Its main characteristics are the following:

- The company is an entity with a separate and distinct personality from its members and the liability of its members is limited to their share contribution
- The minimum number of shareholders is seven and there is no maximum
- The minimum number of directors is two and there is no maximum number. Directors may be local or foreign, natural or legal persons. However, it is suggested that the majority of directors are Cypriot residents so as to ensure that the company is managed and controlled in Cyprus in order for the Company to be considered Cyprus resident for tax purposes and be able to benefit from relevant double tax treaties
- The minimum amount of share capital is €25,629
- Invitations to the public for subscribing for shares or debentures are allowed
- Issuance of bearer shares is prohibited
- The Company must have a registered office in Cyprus
- The Company must have a secretary, who may be local or foreign, natural or legal person. It is customary for compliance purposes for the secretary to be local
- Meetings of shareholders and board of directors may be held anywhere in the world, but for tax purposes it is advisable for, at least board meetings, to be held in Cyprus
- The company must have a memorandum and articles of association prepared by a lawyer in Cyprus, which must be signed by the subscribers and filed with the Registrar of Companies in Cyprus
- There is no restriction in transferring shares.

## COMPANY LIMITED BY GUARANTEE

A company limited by guarantee is a private company in which the liability of its members is limited by the memorandum to the amount that the members undertake to contribute to the assets of the company in the event of the company's winding up.

This type of company is mostly used for associations, charities and for the promotion of non-profitable interests such as education, art, science and sports.

The memorandum of a company limited by guarantee must contain a provision stating that each of its members undertakes to contribute to the company's assets in the event of it being wound up while she/he is a member, or within one year after she/he ceases to be a member, a sum which will not exceed a specified amount.

It should be noted that the guarantee applies in relation to amounts with respect to the debts and liabilities of the company and the costs of it being wound up. Also, past members of the company are only liable for the company's debts and liabilities which occurred before they ceased to be members.

A company limited by guarantee may be incorporated with or without any share capital. A company limited by guarantee without any share capital constitutes the guarantee company in its pure form, whilst a company limited by guarantee with a share capital is a hybrid form of company which combines elements of both the guarantee and the share company.

Needless to say, this is an unusual type of company since it is not used for business purposes.

## **PARTNERSHIPS**

A partnership is a relationship between two persons (legal persons or natural persons) or more who carry out business together with the purpose of obtaining profit.

Traditionally, Cyprus law allows for general and limited partnerships, but since October 2015 the law provides for partnerships limited by shares.

In a General Partnership all partners are equally and jointly liable with all the other partners for all the debts and obligations of the partnership.

In a Limited Partnership one of the partners (the general partner) is liable for all the debts and obligations of the partnership while the remaining partners (the limited partners) may have limited liability up to the amount they have contributed.

In terms of a Partnership Limited by Shares, which has been also defined as a partnership, having a share capital, the liability of the limited partners is limited up to the amount which remains unpaid (if any), on the shares that they hold (which is just like with companies).

An important distinction which needs to be pointed out between any limited partnership under Cyprus Law and a public or private company limited by shares is that the partnership is not considered as a legal entity with a personality separate and distinct from its partners as it applies in companies limited by shares. Basically, the actions of a partnership are the actions of its partners acting in their personal capacity and in this respect the partners shall be liable in case of an action against the limited partnership.

In light of the fact that a partnership is not a separate legal entity, when taxation arises it is the partners who are subject to taxation and not the partnership per se. The typical tax treatment of a partnership is that the income of the partnership is considered as income of the actual partners. Each partner's share of profit is added to their overall income and shall be taxed accordingly as personal income/corporation tax under the applicable tax laws of Cyprus.



## **CYPRUS INTERNATIONAL TRUSTS**

A Cyprus International Trust (a “Trust”) can be defined as the obligation which is placed upon a trustee by the settlor to manage the trust property for the benefit of the beneficiaries in accordance with the relevant trust deed. Trusts are commonly found in common law jurisdictions.

The settlor of the Trust and the beneficiaries must not be residents in Cyprus during the year immediately preceding the creation of the trust while the trustee, or at least one of the trustees, must be resident in Cyprus for the whole duration of the Trust (and she/he must be a licensed trustee such as a lawyer or an accountant). A Trust may last for an indefinite period. The settlor has the right to reserve many powers including, the powers to revoke or amend the trust, to appoint and remove trustees and protectors, to change the law regulating the Trust or the place of its administration. The trustees of a Trust are bound by confidentiality and cannot disclose information unless they are ordered by a Cyprus Court in special circumstances.

Trusts are usually set up for wealth management purposes and family arrangements, such as to hold property for minors.

It should be noted that other than Cyprus International Trusts, Cyprus law allows the creation of local trusts, where the basis is the similar but not identical, which is something that is beyond the scope of this note.

## **FOUNDATIONS AND SOCIETIES**

Foundations and societies are not really business vehicles and are only used for charitable or non-business purposes.

With respect to foundations, these are entities dedicated to a specific non-profit purpose such as the prevention of poverty or the promotion of education or health. With respect to societies, there are entities where at least twenty people contract for the achievement of a non-profitable purpose and it does not include political parties or trade unions.

Needless to say, these types of organisations are uncommon for international businesses.

Cyprus offers an attractive, efficient and transparent tax regime fully compliant with EU and OECD standards, complemented by and enhanced by an extensive network of over sixty double tax treaties, and is an ideal destination in terms of tax incentives and advantages for both legal and natural persons.

## INDIVIDUALS

An individual resident in Cyprus is liable to tax on his/her worldwide income, irrespective of whether it is remitted in Cyprus or not. Non-resident individuals are liable to income tax in Cyprus only on income sourced in Cyprus, for example rental income.

An individual is considered to be resident in Cyprus for tax purposes if he is present in Cyprus for more than 183 days in the year under consideration. This 183 days' requirement can go down to at least 60 days if the relevant individual is not tax resident in any other jurisdiction in the world.

The tax rates for individuals are progressive starting from 20% and going up to 35% as provided in the table below:

Annual Income €	Rate %	Rate %	Cumulative Tax €
0 – 19.500	0%	Nil	Nil
19.501 – 28.000	20%	1.700	1.700
28.001 – 36.300	25%	2.075	3.775
36.301 – 60.000	30%	7.110	10.885
60.001 – above	35%		

There are various deductions in relation to the above tax rates such as payments to registered charities and payments into pension/insurance and social insurance plans

A non-resident who takes up employment in Cyprus and becomes resident is permitted a 20% tax free allowance with a maximum of €8.550 on his/her employment income for a period of three years, following the first year that he/she becomes a Cyprus resident.

A non-resident who takes up employment in Cyprus, earning an annual employment income exceeding €100.000 is allowed a 50% tax exemption on this income for a period of five years.

It, most importantly, should be noted that high-net worth individuals can benefit massively from the jurisdiction's resident-non-domiciled regime. Individuals who are considered to be non-domiciled in Cyprus, can benefit from no tax on certain categories of income such as interest, rents and dividends for a period of up to 17 years from the date that the relevant individual becomes a tax resident of Cyprus. This has proved extremely beneficial for many high net worth individuals over the last few years, who have decided to take this opportunity for wealth management purposes.

Dividend income is taxed in Cyprus only against Cypriot tax residents (individuals) at a flat rate of 15%. Interest income is again only taxed in Cyprus against Cypriot tax residents (individuals and companies) at a flat rate of 30%.

## **COMPANIES**

A company resident in Cyprus is liable to tax on its worldwide income.

A company is considered as resident in cyprus if its management and control is in Cyprus. Non-resident companies are liable to corporation tax in Cyprus only on income sourced in Cyprus, for example rental income. The same applies to branches of foreign companies in Cyprus, unless their management and control is in Cyprus.

The corporation tax rate is a flat rate of 12.5% which is one of the lowest in the EU and the lowest in the Eurozone, thus making Cyprus an ideal country for setting up a business.

Dividend income is exempted from corporation tax and only Cypriot resident individuals pay a contribution to the state in relation to that.

Profits from disposals of securities are exempted from corporation tax and so are profits from a permanent establishment abroad (subject to certain restrictions).

There are also group loss relief benefits and losses carried forward (for up to five years).

## **WITHHOLDING TAXES**

No withholding taxes apply with respect to (a) dividends paid to non-residents, (b) interest paid from Cyprus to non-residents, (c) royalties paid from Cyprus to non-residents (with the exemption where the relevant intellectual property is used in Cyprus, in which case the withholding tax rate is at 10%), and (d) income on the liquidation of a Cypriot holding company.

## WITHHOLDING TAXES

No withholding taxes apply with respect to:

- a. Dividends paid to non-residents
- b. Interest paid from Cyprus to non-residents
- c. Royalties paid from Cyprus to non-residents (with the exemption where the relevant intellectual property is used in Cyprus, in which case the withholding tax rate is at 10%)
- d. Income on the liquidation of a Cypriot holding company

## TONNAGE TAX SYSTEM

An attractive tonnage tax system is in place and can be utilised, subject to certain conditions, by the shipping sector and covering three main international maritime activities, namely ship-owning, ship management and chartering. Under the tonnage tax system, no tax is imposed on profits from shipping activities other than tonnage tax, no tax is imposed on profits from the sale of ships, and no tax is imposed on dividend paid from shipping profits.

## CAPITAL GAINS TAX AND INHERITANCE TAX

Capital gains tax is only imposed on gains from the disposal of real estate, provided that such real estate is situated in Cyprus. The same goes to disposals of shares in limited companies whose main activity is the sale of real estate in Cyprus. No capital gains is imposed on anything else under Cyprus law.

There is no inheritance tax in Cyprus.

# Cyprus | FOREIGN INVESTMENT

Cyprus offers a strategic location at the crossroad of three continents, advanced infrastructure and high quality of life. It is an ideal investment gateway to the EU, as well as a portal for investment outside the EU, particularly into the Middle East, CIS, India and China. As a member of the wider EU and Eurozone community, Cyprus offers to investors both safety and stability, as well as market access to more than 500 million EU citizens. The local infrastructure is ideally suited for business people who need to get things done due to its modern road network, extensive port facilities and its two new international airports.

One of Cyprus' strongest advantages is its human talent – Cyprus has a diverse, well-educated, highly skilled and multi-lingual workforce which provides top quality services, including accounting, auditing, tax, business administration, legal, investment and funds management. This advantage is complemented by a plethora of banks, a robust and transparent legal system based on common law, and a regulatory framework that ensures transparency and reliability in business practices. Cyprus' legal system is widely recognised as a business-friendly and effective system which is also fully compliant with the EU and international regulations against money laundering.

Finally, Cyprus provides tax-efficient structures, which makes it very attractive in terms of relocation of a business and even its current employees, but also wealthy individuals due to its attractive resident non-domiciled program.

## REGISTRATION OF INVESTMENT

As a main rule, there are no requirements for foreign investors to register or obtain the authorities' permission for making investments, and there are no restrictions on the foreign ownership of Cypriot shares or bonds.

Cypriot companies must submit a registration to the Department of the Registrar of Companies and Official Receiver and to the tax authorities before they start operations.

With regard to investments in real estate in Cyprus, EU nationals and Cypriot companies controlled by EU nationals can register any type of property in their name without restrictions. Non-EU nationals/Cypriot companies controlled by non-EU nationals must obtain permission from the Council of Ministers (which has assigned this power to the District Officers of the district where the property is located) to register property in their names and there are restrictions with respect to the size and use of such property. This permission is granted more or less as a matter of course to all bona fide purchasers unless it is considered to be against public interest. Please see the chapter regarding Real Estate for further information.

## SETTING UP A BUSINESS

A standard company takes 5–10 days to register with the Registrar of Companies and Official Receiver and the tax authorities before it is up and running.

## FOREIGN EMPLOYEES

Nationals of other countries within the EU or European Economic Area (EEA) are allowed to work and live in Cyprus without obtaining a work permit or other permits (but notifications must be made to the authorities).

Nationals of countries outside the EU or EEA will need a permit to enter and work in Cyprus. The type of permit required depends on, among other criteria, the employee's salary, whether the employer is a company of foreign interests or not, and the type of work to be performed in Cyprus.

## CITIZENSHIP AND IMMIGRATION PERMITS

The Cyprus government has introduced two schemes for granting foreign investors Cypriot citizenship and permanent residence in Cyprus.

### ► Cypriot citizenship

*Investors can acquire the Cypriot citizenship on economic grounds, by making an investment of at least €2,000,000 in one of the following categories:*

- |  |   |  |
|--|---|--|
| 1. Real estate, land development and infrastructure projects | 3. Alternative investment funds or financial assets of Cypriot companies/organisations that are licensed by the Cyprus Securities and Exchange Commission | 4. A combination of the above, which can also include investment in government bonds of up to €500.000 |
| 2. Financial assets of Cypriot companies or organisations    |   |  |

In addition to this, the investor must own a permanent privately-owned residence in Cyprus of at least €500.000 (+VAT if applicable). It is noted that in case the value of such residence exceeds the amount of €500.000, part of the additional amount can be used for supplementing the total amount of the investment made. It is further noted that if the investment is made into residential properties as per (i) above, the investor does not need to own a separate permanent privately-owned residence if at least one of the units is worth at least €500.000 (+VAT if applicable) and the investor retains the possession of the residence for life.

The investor's spouse/partner, children (minor and adult under certain circumstances), as well as the investor's parents (with the purchase of a permanent privately-owned residence) are also entitled to obtain Cypriot citizenship without the need to make a separate investment.

► **Permanent residency (immigration permit)**

*Non-EU investors can become permanent residents of Cyprus by applying for an immigration permit if they meet the following criteria:*

- |   |  |  |
|---|--|--|
| 1. Deposit of €30.000 into a bank account in Cyprus, which will be pledged for a period of at least 3 years | 2. Provision of evidence of a secure annual income of at least €30.000 (plus €5.000 for every dependent person (spouse and children) and €8.000 for every dependent parent or parent-in-law) | 3. Purchase of real estate of total market value of at least €300.000 (+VAT) |
|---|--|--|

*It is noted that this type of permit does not allow the undertaking of any form of employment in Cyprus. Finally, holders of this permit must visit Cyprus once every two years in order to maintain it.*

*It should be noted that there are other types of residence permits to be acquired, including working permits that are not necessarily based on high investments, but such permits take longer to get and they are indeed more difficult to get.*

*Finally it should be noted that for all citizenship and other immigration programmes, there are very high level anti-money laundering and terrorist activities checks, which suggests that it would be difficult for someone who is not completely clean to acquire citizenship or any type of permit.*

Below is a brief overview of some of the main legislation and obligations which employers must know when employing persons in Cyprus.

## **COLLECTIVE AGREEMENTS**

Many Cypriot employees are members of a trade union, and many collective agreements are in force within the Cypriot labour market. Collective agreements can apply to a “business/company” level or even to a “sector of economy” level e.g. to employees working in hotels or the construction sector. There are sectors of economy which are partly or completely covered by collective agreements such as the semi-government sector, the banking sector and the local council sector.

Collective agreements contain terms such as wages, salary increases, working hours, overtime payment, annual leave, pension etc. Although it is voluntary for an employer to enter into a collective agreement in sectors which are typically covered by such agreements, in practice, an employer that does not enter into such an agreement may face difficulty in attracting and sustaining a qualified workforce, especially if the employment terms offered by such employer are less favourable than the terms provided by the collective bargaining agreement.

Collective agreements are not legally enforceable documents. Nevertheless, due to custom and practice, and with the passage of time, where these are enforced they eventually become incorporated in the personal terms of employment of each employee, and thus become legally binding.

The fact that collective agreements are not legally enforceable documents means that disputes arising from their violation cannot be settled in the Labour Disputes Court but are dealt with according to the provisions laid down in the Industrial Relations Code (a gentlemen’s agreement between the main trade unions and employer organisations for the settlement of disputes).

## **THE EMPLOYERS’ OBLIGATION TO INFORM OF THEIR EMPLOYMENT TERMS**

According to the relevant legislation, the employer is legally obliged to inform its employees of all essential employment terms within one month from the date of commencement of employment.



Such information must be provided in writing, typically in the employment contract, an offer of employment letter or any other document signed by the employer. The employer can also make reference to any laws, regulations, orders or collective agreements, but only in relation to certain terms of employment. The law specifies only the minimum terms that the employee must be notified of, so the employer must consider whether it would be better to prepare an employment contract that fully reflects the terms of employment.

## **WAGES**

In Cyprus, the minimum wage is set only for certain occupations (namely shop assistants, nurse's assistants, clerks, hairdressers and nursery assistants), as such occupations are not typically covered by collective bargaining agreements and employees working in such occupations do not typically have a lot of bargaining power. The minimum monthly wage for employees in these occupations upon recruitment is €870 and increases to €924 for employees who have completed a six-month period of employment at the same employer.

## **WORKING HOURS AND ANNUAL LEAVE**

The standard number of working hours in employment contracts and collective agreements is 38–40 hours per week. The law on working hours provides, amongst others, for minimum daily and weekly rest, minimum break time, annual leave, maximum weekly working hours and night work. Employees are entitled to at least 11 continuous hours of rest per day. The average maximum weekly working hours should not exceed 48, including overtime. The maximum limit can only be extended if the employee consents to this and only if the employee can refuse extending this without incurring any adverse consequences.

Employees that work for 5 days per week are entitled to a minimum of 20 days annual leave (or 21 days if the company is exempted from the 8% holiday fund contribution) and employees that work for 6 days per week are entitled to a minimum of 24 days annual leave (or 25 days if the company is exempted from the 8% holiday fund contribution). The annual leave is paid either directly by the employer or by the Central Holiday Fund. Employers have an obligation to contribute to the Central Holiday Fund unless they obtain an exemption on the basis that they offer more favourable terms than those provided by the law to their employees.

## **MATERNITY, PATERNITY AND PARENTAL LEAVE**

Employees who become parents have the following rights:

1. Women are entitled to a total maternity leave of 18 weeks, 11 of which must be taken during the period beginning 2 weeks before the expected birth week.
2. Women are entitled to a maternity grant of 72% of their insurable earnings from the Social Insurance Fund for 18 consecutive weeks, starting at least 2 weeks prior to the expected birth week.
3. Women who gave birth and are breastfeeding or have increased responsibilities for the care/raising of the child, can, for a 6-month period commencing on the date of birth or maternity leave, interrupt their employment for one hour or go to work one hour later or leave work one hour earlier. The one-hour excuse period is considered working time.
4. Men are entitled to take 2 consecutive weeks of paternity leave within the period starting from the birth week and ending 16 weeks thereafter. Men are entitled to a paternity grant of 72% of their insurable earnings from the Social Insurance Fund for the whole of the period of their paternity leave.
5. Between the period starting after the expiry of the maternity/paternity leave and ending on the completion of the child's 8th year, each parent is entitled to parental leave for 18 weeks. Parental leave is unpaid.

Women are statutorily protected against termination of employment/notice of termination of employment during the period starting from the beginning of the pregnancy and ending 3 months after the end of their maternity leave provided that they notify their employer of their pregnancy in writing. This does not apply in redundancy situations or in cases of gross misconduct or, if employees are on fixed term employment, their contract period has expired.

Men are also statutorily protected against termination of employment/notice of termination of employment during the period starting from the date of the written notice of the employee for his intention to exercise his right to paternity leave until the expiry of the paternity leave. This does not apply in cases where they are found guilty of gross misconduct, or the employer closes down or, if they are on fixed term employment, their contract period has expired.

### **NON-DISCRIMINATION**

It is prohibited to discriminate, directly or indirectly, on the grounds of gender, racial or ethnic origins, sexual orientation, age, disability and religion (and religious beliefs).

Non-compliance with the law is punishable by a payment of a fine or by imprisonment or both. Compensation to the employee (or job applicant) may also be payable.

### **TERMINATION OF EMPLOYMENT**

The Termination of Employment Law provides for an exhaustive list of grounds that can be based upon for lawful termination. These are the following:

- |   |                                  |  |
|---|----------------------------------|--|
| 1. Omission/failure of the employee to perform his/her duties in a reasonably satisfactory manner | 3. Force majeure                 | 6. Completion of retirement age  |
| 2. The employee has become redundant  | 4. Expiry of fixed-term contract | 7. The conduct of the employee has made the employee subject to dismissal without notice |
|   | 5. Completion of pension age     |  |

The employment legislation has a provision for a minimum probation period of at least 26 weeks which may be extended up to 104 weeks in writing. In the event of termination of employment during the probation period, there is no minimum notice period. After the expiry of the probation period of an employee, termination for any reason other than one of the abovementioned grounds is unlawful. The burden of proving that a dismissal was lawful is on the employer (unless the employee resigned claiming constructive dismissal, in which case the burden of proof lies with the employee).

If a court determines that the dismissal is unjustified, the employer will be liable to pay compensation to the employee.

There are minimum statutory notice periods for both the employee and the employer depending on the duration of employment, but this does not prohibit the parties to agree longer notice periods than those provided by the law in collective agreements or the individual employment agreements.

### **COLLECTIVE REDUNDANCIES**

The Collective Redundancies Law may be applicable when employees are made redundant, depending on the number of affected employees and the number of employees employed by the employer in general. This law requires that the employer is obligated to inform and consult the employees before contemplated redundancies become effective, as well as to inform the Ministry of Labour, Welfare and Social Insurance.

### **TRANSFERS OF UNDERTAKINGS**

The Safeguarding of Employees' rights in the Event of Transfers of Undertakings, Businesses or Parts of Businesses Law, which implements the Directive 77/187/EEC, protects employees' rights in the event of a transfer of a business or part of a business.

In the event of a transfer of a business or undertaking, the employment rights and obligations of the employees of the business or the part of the business being transferred will automatically be transferred to the new owner of the business who will automatically assume those rights and obligations instead of the vendor for a reasonable period of time.

## TYPES OF REAL ESTATE

1. In Cyprus, one can either own or rent real estate, regardless of whether it is for business or private purposes.

## OWNERSHIP RESTRICTIONS

1. EU nationals and Cypriot companies controlled by EU nationals can buy any type of property without restrictions.
2. Non-EU nationals and Cypriot companies controlled by non-EU nationals are only entitled to register real estate in Cyprus in their name if they obtain permission from the Council of Ministers (which has assigned this power to the District Officers of the district where the property is located). This permission is usually granted unless the reputation of the applicant is questionable and it is considered to be against the public interest to grant such permission to the applicant.

## REGISTRATION IN THE LAND REGISTRY DEPARTMENT

1. In Cyprus, immovable property is purchased pursuant to a purchase agreement, followed by a deed of transfer, which is entered at the Land Registry Department. This land register shows the identity of the owner, all registered mortgages and encumbrances in relation to the property etc. In most cases, all other burdens and easements such as right of way etc. will also appear on the register.
2. Property title deeds might not be available for all immovable property and in such case, the purchase contract is lodged with the Land Registry Department as an encumbrance upon the property until the title deeds for that property are issued. Once the title deeds are issued, the transfer of the property takes place provided relevant transfer fees are paid.
3. The land register system also serves as an easy and dependable way of providing security to lenders, as the ranking of priority of lenders will appear clearly on the property's list of mortgages and encumbrances. The registration of the mortgage will protect the mortgagee's rights against the mortgagor's other creditors.

## LEASES

1. Almost all terms and conditions of leases are subject to the parties' negotiations, including terms and conditions regarding rent, adjustment of rent, maintenance obligations, right of assignment, subletting, and the like.
2. It should, however, be noted that in the event of early termination by the lessee, the lessor will have the obligation to mitigate his/her loss as a matter of contract law and mitigation will be an important factor in measuring damages.
3. It should also be noted that with certain old properties it might prove extremely difficult to evict a tenant due to complexities into relevant legislation and to provisions giving the right to a tenant not to be evicted. This is a complicated area of law and things tend to be looked at on a case by case basis.

# Bányaiová Vožehová, S.R.O. Advokátní Kancelář

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Czech Republic

📍 Lazarská 13/8  
120 00 Praha 2

☎ +420 222 513 681  
+420 602 625 212

☎ +420 222 517 088

info@damianoslaw.com

www.bvlaw.cz

## General Information

Established in 2010, Bányaiová Vožehová, has the flexibility of a boutique firm, combined with the advantage that most of its lawyers have extensive experience from large global law firms. This allows us to offer our clients the best combination of the understanding of the local market and a global approach. We provide high quality complex legal services to both foreign and Czech legal entities, individuals as well as public law authorities at reasonable costs.

We provide our clients with professional care and we always try to find a solution that fits their needs best. Our services are always efficient and our personal approach to clients helps developing long-term cooperation and relationships that we value deeply.

We are members of a unique network of law firms called E-IURE which is based on combination of high quality law firms and trustful relationship among them.

We provide legal services and communicate with the clients in Czech, English, German and Spanish.

## Main Areas of Practice

Our team is led by partners with extensive and long-time practice in international law firms who have vast experience with working on projects and transactions reaching to various areas of law. We provide legal services mainly in the following areas:

- Mergers and acquisitions
- Commercial and corporate law
- Real Estate
- Dispute Resolution
- Competition Law
- Labor Law
- Bankruptcy
- Capital markets and securities
- Banking and finance
- IP and IT
- Foreign investment/joint ventures
- Criminal Law

# Czech Republic | CORPORATE LAW

As of 1 January 2014, the Czech Republic has enacted new legal regulation including the rules regarding the corporate law. The main regulation of the corporate law is contained in Act No. 90/2012 Coll., on Business Companies and Cooperatives (Act on Business Corporations), as amended, and in Act. No 89/2012 Coll., the Civil Code, as amended.

## TYPES OF COMPANIES AND LIABILITY OF SHAREHOLDERS

Under Czech law, general partnership, limited partnership, limited liability company, joint-stock company, European Company and European Economic Interest Grouping are considered commercial companies or corporations. Besides these, the Czech law knows also cooperatives as additional legal form.

All companies and cooperatives are registered in the Commercial Register held by regional courts. Individual entrepreneurs may also be registered in the Commercial Register, otherwise if they hold a trade license, they are registered in the Trade Register.

### ► Joint-Stock Company (in Czech: *akciová společnost*)

*The joint-stock company is a separate legal entity the share capital of which is apportioned to certain number of shares. Shareholders are not liable for liabilities of the company (except for one extraordinary case). It is established by executing the Articles of Association before a Czech notary. The Articles of Association need to include the essentials set out in the applicable regulations. The joint stock company is established by registration into the Commercial Register, where the Articles of Association become part of the Collection of Deeds which is publicly accessible, mostly even online. The statutory minimum share capital is EUR 80,000. At least 30% of the share capital must be paid in by the date of application for registration of the company in the Commercial Register. Joint-stock company is the corporate form adopted by larger companies with the major advantage that its shares can be transferred rather easily and, theoretically, be listed on a stock exchange, making it relatively easy to raise capital from the public.*

### ► Limited Liability Company (in Czech: *společnost s ručením omezeným*)

*The second form of corporations under Czech law is the limited liability company, which is the corporate entity most commonly used for enterprises in the Czech Republic. The minimum share capital of a limited liability company is lowered to CZK 1.00, i.e. less than EUR 1, as of 2014. The liability of shareholders for liabilities of the company is limited to the amount of the aggregate of their unpaid contributions according to the state of registration of contributions payment in the Commercial Register at the moment they have been invited by the creditor to pay it (except for one extraordinary case). It is easier to establish and administer than the joint-stock company.*

*Local and foreign corporations and partnerships as well as individuals may become shareholders of a limited liability company. It is established by executing a Memorandum of Association or a Foundation Deed (in case of one shareholder) before a Czech notary. Again, the Memorandum of Association needs to include the essentials set out in the applicable regulations. The limited liability company is established by registration into the Commercial Register, where the memorandum of association becomes part of the Collection of Deeds.*

► **General Partnership (in Czech: veřejná obchodní společnost)**

*General partnership is a company of at least two persons who participate in its business and administration of its assets and are liable jointly and severally for its liabilities.*

► **Limited Partnership (in Czech: komanditní společnost)**

*Limited partnership is a company in which at least one partner is fully liable for all debts and at least one partner whose liability is limited to the amount of its unpaid contribution.*

► **Cooperative (in Czech: družstvo)**

*A cooperative is an association of unlimited number of persons established to provide mutual support for its members or third parties or for business purposes. The cooperative shall have at least three members. Cooperatives are not so often used for business purposes and if they are, it is in traditional sectors such as agriculture. Only the members of the cooperative can be elected to the functions of the members of the bodies of the cooperative.*

*A special type of cooperative is a housing cooperative established to provide for housing needs of its members and social cooperative established to carry out activities for public benefit, aimed at supporting social cohesion in order to ensure labor and social integration of disadvantaged groups into the society, preferably by meeting the needs and using the resources local to the registered office and sphere of activities of the social cooperative, particularly in the areas of job creation, social services and health care, education, housing and sustainable development.*

► **Branches**

*A foreign company not interested in doing business through a separate Czech legal entity may establish a branch. The branch has to be registered in the Commercial Register. Although contracts may be signed in its name, a branch is not a separate legal entity. For its registration, the court will request evidence of the existence of the foreign company.*

*Business may be also conducted through a silent partnership or a civil-law association which, however, are not considered separate legal entities.*

*The Czech legal system also knows other types of the legal entities, however these are not established for business purposes (e.g. Foundations, etc.).*

## **SHARE CAPITAL**

As mentioned above, the statutory minimum share capital is EUR 0.04 for the limited liability company and EUR 80,000 for the joint-stock company. It has to be subscribed in full. Contributions can be made in cash or in kind. The share capital of a limited liability company is divided into ownership interests which are

not issued in the form of certificates. Each shareholder holds an ownership interest corresponding to the amount of the original contribution, if not agreed otherwise. The Memorandum of Association may allow for different types of ownership interests to be formed. Each type shall be comprised of ownership interest associated with the same rights and duties. If provided by the Memorandum of Association, the shareholders can own more than one ownership interest in the company.

An ownership interests in a limited liability company may be transferred by assignment or inheritance. The contractual transfer can be made conditional upon the consent of the General Meeting of the company.

If provided by the Memorandum of Association, the ownership interests of the company may be represented by a common certificate. A common certificate can only be issued for the ownership interests that are not subject to any restrictions or conditions regarding its transferability. The common certificate is a security which can be transferred to other person in the same way as in case of joint-stock company shares, however it may not be subject to public offering or admitted for trading on a European regulated market or other public market and it cannot be issued as a book-entry security.

The share capital of a joint-stock company is divided into shares issued in the form of certificates. They may be issued as registered shares which contains the name of its owner and also the name of the owner is registered in the company's share register and may be issues either as certificates or as book-entry shares. Bearer shares can be only issued as book-entry securities. It means that there is not possibility to issue "anonymous" shares. Additionally, shares can be issued as ordinary shares or preferred shares. Bearer shares enjoy free transferability. The corporation is not allowed to restrict in any way their transfer, whereas a transfer of registered shares might subject to conditions (such as a consent of the General Meeting of the company or another corporate body) stipulated by the Articles of Association. In relation to the new Act No. 134/2016 Coll., on Public Procurement, effective as of 1 October 2016, the joint-stock companies shall book-entry their shares in case they wish to participate in public tenders. In case the shares of the company are not book-entry securities, the contracting authority can exclude such company from the tender.

## **CORPORATE GOVERNANCE**

Shareholders decisions are made through shareholder resolutions passed in General Meetings in case of joint-stock companies and limited liability companies and partners meetings in case of partnerships.



**► Joint Stock Company**

*The formal bodies of a joint-stock company are the General Meeting, the Board of Directors and the Supervisory Board. An individual cannot simultaneously be a member of both the Board of Directors and the Supervisory Board. The General Meeting is the supreme body of a joint-stock company. It must be held at least annually no later than 6 months from the end of the company's financial year. In case of a sole-shareholder, it fully acts in the capacity of the General Meeting and can decide on all matters that belong to the competences of the General Meeting according to legal regulation or Articles of Association of the company (e.g. approval of the Financial Statements, recall and election of the members of the bodies of the company, changing the Articles of Association, dissolution of the company, etc.).*

*Generally, the General Meeting constitutes a quorum if the present shareholders hold shares with the nominal value that exceeds 30 % of the registered capital of the company unless provided otherwise in the Articles of Association. A simple majority of votes is sufficient for most decisions, e.g. when electing and reappointing members of the Board of Directors and the Supervisory Board, as well as approving Financial Statements and profit allocations, unless mandatory law or the Articles of Association require a greater majority as may be the case for amendments to the Articles of Association or increases or decreases in capital, or change of the corporate form.*

*The statutory body of a joint-stock company is the Board of Directors. Members of the Board of Directors are elected by the General Meeting, unless the company's Articles of Association entrust this power to the Supervisory Board. The Board of Directors oversees the day-to-day operations of the company and it is responsible for maintaining proper accounting and reporting procedures. The members of the Board of Directors act and sign on behalf of the company in the manner stated in the Articles of Association. The Board of Directors is a collective body and its members have to decide on any matter by their majority, unless any specific area is delegated to the powers of any of the members of the Board of Directors. However, it is necessary to differentiate between deciding on the matters of the company and acting on behalf of the company.*

*A joint-stock company must have a Supervisory Board elected by the General Meeting. The Supervisory Board monitors the activities of the Board of Directors and the performance of the company, as well as reviews the Financial Statements and the proposed allocation of profits or compensation for losses. In case the company has more than 500 employees, the number of members of the Supervisory Board shall be divisible by three and at least one third of the members of the Supervisory Board shall be elected by the employees of the company.*

*The system of Board of Directors and Supervisory Board is designated as the dualistic system and it was the only possible system until the end of 2013. As of 1 January 2014, the Act on Business Corporation introduced also the monistic structure with the Managing Director as the statutory body and the Management Board as the supervisory body which, however, determines the basic goals of business management. It is also possible to concentrate the powers of the two bodies into one person. The dualistic system of organization of the company still prevails.*

**► Limited Liability Company**

*The General Meeting is also the supreme statutory body of a limited liability company and possesses rights similar to those of the General Meeting of a joint-stock company. The General Meeting must be held at least annually no later than 6 months from the end of the company's financial year. Again, in cases of a sole-shareholder, it fully acts in the capacity of the General Meeting. The General Meeting constitutes a quorum if the shareholders holding at last one half of the votes in the company are present at the General Meeting of the company, unless the Memorandum of Association of the company stipulates otherwise. One vote pertains to each CZK 1 (approx. EUR 0.04) of the contribution to the registered capital of the company and the majority of votes of the present shareholders is required for the adoption of the decisions, unless the Memorandum of*

Association set otherwise. For some types of decisions, a higher number of votes is required (e.g. change of the Memorandum of Association).

The General Meeting elects one or more Executive Directors. No Board of Directors is required. The Executive Director is the statutory body of the limited liability company and oversees the day-to-day operations of the company, it is responsible for maintaining proper accounting and reporting procedures and acts on behalf of the company by the manner stated in the Memorandum of Association. The Executive Directors are individual bodies and for the decision on the matters of the company, the consent of the majority of the Executive Directors is required unless the Memorandum of Association stipulates otherwise. The Memorandum of Association may also set that the Executive Directors form a collective body and in such case, the same rules for the decision making as in case of the joint stock company apply. A Supervisory Board may be established for a limited liability company, but it is not mandatory. An individual cannot simultaneously be the Executive Director and a member of the Supervisory Board. Also, any other person authorized to act on behalf of the company and registered in the Commercial Register cannot be a member of the Supervisory Board of the limited liability company.

#### ► Relationship Between Company and Member of a Corporate Body

The relationships between the members of the bodies of the company and the company (their rights and obligations) are usually regulated by the agreement on performance of function. The agreement on performance of function has to be concluded in writing and the agreement and its changes have to be approved by the General Meeting of the company. The agreement on performance of function has to contain all remunerations (monetary and also non-monetary) that will be provided by the company to such member. In case the agreement on performance of function does not contain any remuneration, it shall be presumed that the performance of function is free of charge. Any other remuneration in favour of the person who is a member of a body of a business corporation other than those, to which the person is entitled to under legal regulations, the agreement on performance of function approved by the General Meeting or an internal document approved by the General Meeting, can only be granted with the consent of the General Meeting and subject to the opinion of the Supervisory Body, if established.

## COMMERCIAL REGISTER

Under the Czech law, third parties rely on the information provided by the Commercial Register for any given company, in particular in determining which person can act on behalf of the company to bind the company. Furthermore, any change affecting the information registered in the Commercial Register shall be notified to the Court without any undue delay so that the Court can register such change in the Commercial Register.

Besides the obligation to register all changes in the Commercial Register, the companies shall file some of their corporate documents to be publicly available in the Collection of Deeds of the Commercial Register, e.g. whole wording of the Articles of Association/Memorandum of Association/Foundation Deed and its changes, decision on recall and election of the members of the corporate bodies, Annual Financial Statements, decision of the General Meeting on the economic result of the company, Report on Relationships, etc.

# Czech Republic | TAX LAW

Czech Republic's tax system is broadly based upon other taxation systems in the EU. The regulations were drawn up at the beginning of 1990's and came into force in 1993. Value-added tax and excise duties were adjusted in 2004, upon Czech Republic's EU accession. Tax laws are subject to frequent amendments, one of the major amendment was adopted together with the new Czech private law, effective as of 2014.

## INCOME TAXES

Income taxes for both individuals and legal entities are regulated by Act No. 586/1992 Coll., on Income Taxes, as amended. Income tax is levied on the worldwide income of Czech residents and on foreign entities whose place of management/control is located in the Czech Republic. For non-resident entities, only income which is generated in the Czech Republic is subject to the income tax.

## INDIVIDUAL TAXES

Individuals who are physically present in the Czech Republic for 183 days or more in a calendar year or who have established a permanent residence in the Czech Republic are treated as tax residents and are generally subject to taxation on their world-wide income in the Czech Republic. Individuals who spend less than 183 days in a calendar year in the Czech Republic and do not have a permanent residence in the Czech Republic are treated as tax non-residents. They are liable to taxation on their Czech-source income, however, only subject to the provisions of the respective double taxation treaty.

The following types of income are subject to individual income tax:

### ► Income From Dependant Activities and Functional Benefits

*It includes all income arising from employment, membership relationship, or a similar kind of relationship in which the taxpayer is obliged to follow his employer's instructions and income paid to Executive Directors and members of statutory bodies of legal entities. In addition to the basic salary, cash allowances and bonuses, the employment income also includes non-cash benefits provided to employees (e.g. company cars used for private purposes, etc).*

► **Income from Business Activities and Other Self-Employment**

*It consists of income from business activities and professional services reduced by deductible expenses. Different lump-sum expenses can be deducted for defined groups of individuals (e.g. expenses in amount of 80% of income for craftsmen, 40% of income for doctors, legal and accounting advisors etc., however calculated from limited amount of income).*

► **Capital Gains**

*Capital gains are defined as the difference between the proceeds from the sale of an item and the cost of its acquisition plus any improvements. In the Czech Republic, capital gains are taxed as ordinary income. The sale of securities is exempt from taxation if the shares have been held for a period of more than 3 years or if total income from the sale of securities does not exceed CZK 100,000 (approx. EUR 3,840) for individual taxpayer per tax period.*

► **Income From Leases**

*Income from the lease of the real estate or movables. Lump-sum expenses in amount of 30% of income (maximum CZK 300,000, approx. EUR 11,520) may be deducted.*

► **Other Income (Inheritance and Gift Tax)**

*Among other things, inheritance and gifts are taxed within this category. All income from inheritance is an exempt from tax. Income from gifts is an exempt from tax provided that the donor and the gift recipient are relatives or if they share the same household for more than 1 year. Moreover, income from gifts is an exempt also if the gifts are received occasionally and the value of the gifts from one donor is less than CZK 15,000 (approx. EUR 576) per tax period.*

*The flat rate income tax of 15 % is currently applicable and will most likely remain in force at least till the parliamentary elections held in Autumn 2017. Since the transition to progressive tax system is currently not one of the main political topics, no fundamental change in this matter is expected. However, minor changes of the tax rate during 2018 or 2019 could not be ruled out.*

*Various tax discounts are also applicable. Any individual with a taxable income has a discount on income tax in the amount of CZK 24,840 (approx. EUR 953.9) per year, increased in case of having any children. Additional discount in the same amount may be applied in case that the taxpayer's spouse has a taxable income lesser than CZK 68,000 (approx. EUR 2,611) in a year (e.g. spouse on maternity leave etc.).*

*The taxable period for personal income tax purposes is the calendar year. Personal income tax returns must generally be filed by 31 March following the end of the tax year. This is extended to 30 June if a qualified Czech tax adviser prepares the return and the relevant power of attorney is filed with the Financial Authorities before 31 March.*

*Income tax prepayments are generally required either quarterly or semi-annually during the year based on the previous year's tax liability. Payment of any residual tax due must be made by the respective tax return filing deadline. Special rules apply for payroll tax withholdings on taxable income derived from employment.*

## CORPORATE INCOME TAXES

Corporate income tax is levied on the worldwide income of Czech legal entities and on foreign entities whose place of management/control is located in the Czech Republic. For non-resident entities, only income which is generated in the Czech Republic is subject to corporate tax.

Czech general and limited partnerships are, for corporate income tax purposes, treated as fiscally transparent entities. The profits of a general partnership are not taxed at the company level, but at the level of the partners. Also, profits which are attributable to the general partners of a limited partnership are taxed at the partners' level, whereas profits which are attributable to limited partners are taxed at the company level.

The corporate income tax rate of 19 % is applicable for the tax period of 2017 and will probably remain for 2018.

Investment funds, mutual funds and pension funds are subject to 5 % tax. Corporate income tax is generally payable on trading results (profits or losses) as reported in Financial Statements after an adjustment of various assessable/non-assessable and deductible/non-deductible items has been carried out.

Generally, the taxable period for Czech corporate income tax purposes is the calendar year or the financial year. Calendar year tax returns for corporate income tax must generally be filed by 31 March following the end of the tax year. This is extended to 30 June if a qualified Czech tax adviser prepares the return and the relevant power of attorney is filed with the financial authorities before 31 March or the company is required to have a statutory audit.

A corporation may change its accounting and tax period from the calendar year provided it notifies the financial and tax authorities at least three months before the end of the calendar year or three months before the start of the planned accounting and tax period.

Special rules apply for filing in the case of liquidations, mergers and transformations.

## VALUE-ADDED TAX

VAT is primarily regulated by Act No. 235/2004 Coll., on Value Added Tax, as amended, which is a transposition of the European Union Directive No. 2006/112/ES, on the Common System of Value Added Tax. VAT is generally chargeable on:

1. Supplies of goods and services for consideration during the course of his economic activities with a place of supply in the Czech Republic.
2. The import of goods into the Czech Republic (administered by the customs authorities, unless VAT is applied directly through a VAT return).
3. The intra-community acquisition of goods for consideration effectuated by a taxable person in the course of his economic activities or non-taxable legal person in the territory of the Czech Republic.
4. Intra-community acquisition of new goods meant for transport for consideration effectuated by a non-taxable person.

There are three tax rates, standard, the first reduced and the second reduced. The standard tax rate covers most goods and services, while the first reduced rate applies primarily to food-stuffs and pharmaceuticals and the second reduced rate applies primarily to baby food, cereal products and printed books. In 2017 the standard rate stood at 21 %, the first reduced rate at 15 % and the second reduced rate at 10 %.

In 2016, control reporting of VAT transactions was introduced. According to the new amendment, VAT payers shall provide the tax authorities with an electronic detailed list of completed transactions concerning VAT in monthly terms. Tax authorities may impose fines on persons breaching their duty to report the transactions in due time.

Another recently-introduced change to the VAT is the “reverse charge” mechanism of VAT payment for certain types of goods/services, meaning that the liability to pay VAT is transferred to purchaser (i.e. the receiver of the goods/services) instead of the seller/provider of the service, who is primarily liable for payment of VAT. Examples of “reverse charge” types of transaction are construction or installation works, telecommunication services, purchase of waste and scrap, etc.

## REAL ESTATE RELATED TAXES

The real estate tax is imposed on real property. The tax rates depend on the type/purpose of the building or land, the size and desirability of the locality and the size of the building or land, however the amount of tax for standard types of real property is relatively low. Real estate tax returns must be filed by 31 January of a calendar year. Real estate tax is payable by 31 May and if exceeding CZK 5,000 (approx. EUR 192) it may be divided into two instalments, payable by 31 May and 30 November of the current year; several types of exemptions are available.

Transfer of real estate is subject to transfer tax amounting to 4 % of the purchase price (with some exceptions). Taxable person is the acquirer of the real estate and the tax is payable within three months of the month of registration of the transfer. Transfers without consideration (i.e. inheritance, donation etc.) are exempted from the transfer tax liability.

## **ROAD TAX**

Road tax only applies to vehicles registered in the Czech Republic, used in the Czech Republic in connection with business activity (except for publicly beneficial entities). Vehicles used exclusively for private needs are exempt. The tax for passenger cars is calculated from the car's engine capacity, for heavy-goods vehicles it depends on the number of axles and the total weight. All advance payments are generally due by April 15, July 15, October 15 and December 15, respectively.

The law also sets out a toll for the use of highways, applicable to all vehicles – passenger and freight, used for business or private travel. The fee for heavy-goods vehicles is charged per kilometer travelled using an electronic system; passenger cars pay a fixed sum and get a vignette which is to be placed on the front glass of the car. Extension of the electronic system to all vehicles and some other types of roads is being considered.

## **INHERITANCE TAX, GIFT TAX**

Inheritance and gift are taxed within the income tax, see above.

## **ENVIRONMENTAL TAXES**

Taxes referred to as environmental are governed by Act No. 261/2007 Coll., on Stabilization of Public Budgets, as amended, and are introduced in accordance with EU regulations. They include natural gas tax, solid fuels tax and electricity tax.

## **EXCISE DUTY**

Goods subject to excise duties are mineral oils, alcohol, alcoholic beverages and tobacco products. Similar to the value-added tax, excise duties are also harmonised with European Union's regulations. These taxes are administered by customs authorities.

## **TAX ADMINISTRATION**

Tax administration is regulated by Act No. 280/2009 Coll., on the Tax Procedure Code, as amended. The administration is carried out by the Tax Authorities and, in some cases, customs authorities under the Ministry of Finance of the Czech Repu-

blic. Tax returns may also be filed electronically via data boxes (datová schránka), an electronic tool used for communication and document exchange between public authorities and legal or natural persons engaged in business activities.

### **EET (ELECTRONIC EVIDENCE OF RECEIPTS)**

In 2016, electronic evidence of receipts has been introduced by the Ministry of Finance to increase tax revenues and fight tax evasion. Some types of services providers (doctors, legal and accounting advisors, car services, craftsmen) shall join to electronic evidence of receipts later in March 2018 and June 2018. In connection to this, entrepreneurs must now print receipts for any sales using special software which automatically registers the receipts within the database of Ministry of Finance. If the receipt is not registered right away (e.g. due to internet issues), the entrepreneur must send the receipt to the tax authority via data box within 48 hours after the sale/service is performed. Avoiding the evidence of the receipts is an administrative delict, fineable by the Tax Authorities.



# Czech Rep. | FOREIGN INVESTMENT

## CONDITIONS FOR AN INVESTMENT IN THE CZECH REPUBLIC

In general, there are fairly good conditions for foreign investment in the Czech Republic. Stable, consistent and predictable political and economic environment along with investments incentives are fine motivation for foreign entities to invest their funds in the Czech Republic.

Important aspect for investors to realize their investments in the Czech Republic is especially qualified and reliable workforce, together with advantageous geographical location in the Central Europe, availability of various suppliers and wide options of financing.

The Czech Republic is also a member of various international organizations such as the World Trade Organization (WTO), Organization for Economic Cooperation and Development (OECD), International Monetary Fund (IMF) and North Atlantic Treaty Organization (NATO). Furthermore, as an EU member, the Czech Republic adopts its legislation and standards.

Key industry sectors are automotive industry and mechanical engineering, but also aerospace engineering, nano-technologies and IT industry play its role.

## THE CZECH CURRENCY – THE “KORUNA”

The Czech National Bank as the central bank maintains very high currency stability. The current exchange rate (as of July 2017) is EUR 1 = CZK 26.04. As the Czech National Bank ceased to pursue interventions on the monetary market in April 2017, the Czech currency has the tendency to strengthen, with estimated exchange rate EUR 1 / CZK 25.5 in long-term framework. The Czech currency koruna is fully convertible and there are wide options of exchange rate risk hedging.

## NON-DISCRIMINATION, REPATRIATION OF PROFITS AND TRANSPARENCY

Under the Czech law and also international regulations by which the Czech Republic is bound, discrimination of foreign entities is strictly prohibited and such entities must be treated the same way as domestic entities in all areas. Generally, foreign investors may perform business activities under the same conditions and to the same extent as Czech investors and do not need any special permission or registration for making investment operations in the Czech Republic. Since 2004, acquire of real estates by foreign entities is not limited by Czech laws.

There are in general no limitations regarding distribution and expatriation of profits related to foreign investments. Foreign investors are allowed to transfer profits to their state of origin providing they act in compliance with Czech corporate and tax law.

In order to prevent double taxation of profits, the Czech Republic has concluded treaties with many countries, including the United States, Canada, Australia and all EU members.

Pursuant to the Act No. 253/2008 Coll., on selected measures against legitimization of proceeds of crime and financing of terrorism, as amended, banks and other entities are obliged to identify and check up on investors with regard to the sources of their funds used for investments. Furthermore, since 2018, any legal entity or property trust registered in the Czech Commercial Register or other public register shall provide the administrator of the respective register with identification of the beneficial owner of the registered entity. Generally, this information shall not be disclosed to public, however it would be kept by the by regional courts maintaining the Commercial Register.

### **INVESTMENT PROTECTION**

The Czech Republic is a party to many bilateral treaties whose aim is to protect and support foreign investments. No discrimination based on the origin of the capital is allowed in the Czech Republic and foreign entities are protected against unlawful expropriation of their property by the Czech state.

The Czech Republic is also a member of the Multilateral Investment Guarantee Agency (MIGA), which is a member of the World Bank Group and its mission is among other things to promote foreign direct investment (FDI).

### **INVESTMENT INCENTIVES**

The Czech Republic provides both new and existing investors with various investment incentives through its agency Czech Invest. The main objective of the Czech Invest is to advise and support the existing and new entrepreneurs and foreign investors in the Czech Republic. The Czech Invest provides services as full information assistance, handling of investments incentives, access to EU structural funds, business properties identification, case for existing investors, etc. For more detailed information, you can visit [www.czechinvest.org](http://www.czechinvest.org).

Specific supported areas are:

- |  |  |  |
|--|--|--|
| <p>1. Industry – Introduction or expansion of production in sectors of the manufacturing industry, mainly in designated special industrial zones</p> | <p>2. Technology centres – Construction or expansion of research and development centres</p> | <p>3. Business support services centres – launch or expansion of the activities of shared-services centres, software-development centres, high-tech repair centres, data centres, customer support centres</p> |
|--|--|--|

Types of investment incentives are:

- |  |  |   |
|--|--|---|
| <p>1. Tax incentive – Corporate income-tax relief for up to ten years for new companies</p>          | <p>4. Training and re-training grants – financial support for training and retraining of new employees in less developed regions</p>           | <p>6. Property tax incentive – Property tax exemption up to five years for real estates in special industrial zones</p> |
| <p>2. Discounted price on land and related infrastructure</p>  | <p>5. Cash grant for capital investment – Financial support in the case of strategic investments in manufacturing or in technology centres</p> | <p>7. Technology centres – Construction or expansion of research and development centres</p>                            |
| <p>3. Job creation grants – Financial support for creation of new jobs in less developed regions</p> |  |   |

## STATISTICS AND RATINGS

The Czech Republic has in a long term very positive Foreign Currency Long-Term Sovereign Debt Ratings granted by all three major rating agencies.

- Moody's – A1
- Fitch - A+
- Standard and Poor's

According to the Global Competitiveness Report 2016–2017 prepared by World Economic Forum, the Czech Republic took 31th place in the competitiveness of the world economies ranking. With the score of 4.72, the Czech Republic is the most competitive country in the Central-East Europe.

## STARTING BUSINESS IN THE CZECH REPUBLIC

### ► Sole Entrepreneur

*First of all, every entrepreneur must obtain trade license or any other required permission for its activities before he/she starts performing business activities in the Czech Republic. Generally, the most used permits for business activities are trade licences granted by the Trade Licensing Office. Trade licenses are divided into free (without any special requirements) or regulated trades (specific requirement regarding education, professional certifications etc.). General requirements for obtaining trade license are clean criminal record in entrepreneur's home country or country where he or she lived more than 3 years (evidenced by a criminal record extract or affidavit in some cases) and a confirmation of a registered office in the Czech Republic (consent of the owner of the premises). If the entrepreneur does not fulfill the requirements set for the regulated trades, he/she can appoint an authorized representative for such trade who fulfills such requirements. Fee for applying for trade license is CZK 1,000 (approx. EUR 38.40). The application form may be accessed online at <http://www.rzp.cz/elpod.html>.*

► **Establishing a Branch Office**

*Foreign legal entities may establish a branch office in the Czech Republic, which needs to be registered in the Commercial Register maintained by the Regional Courts (or Municipal Court in Prague) under the name of the parent company's name with addendum "registered branch". Branch office is not considered as a separate legal entity by the Czech law, however it operates as a representative of a foreign entity. Branch office acts through its director and is allowed to conduct only those activities which the parent company lists in the Czech Commercial Register. Branch offices must obtain trade license or any other required permission for performing its business activities as well.*

► **Establishing a Company**

*As in case of the sole entrepreneur, also the company has to obtain trade licences or any other required permission for its activities before the company starts performing its activities. For more details regarding the establishment of the company, please, see the part regarding the Corporate Law.*

# Czech Republic | LABOUR LAW

## FUNDAMENTAL PRINCIPLES

Fundamental principles of the Czech labour relations are particularly legal protection of an employee, satisfactory and safe working conditions, fair salary, equal treatment and prohibition of discrimination. Employee protection provided by the Act. No. 262/2006 Coll., the Labour Code, as amended, is based mainly on international standards, by which the Czech Republic is bound. Even though, it is allowed to regulate rights and duties of parties in the employment contract differently than set in the Labour Code, however, these deviations may be arranged only in favour of the employee. Basically, the provisions of the Labour Code are generally applicable on all employment relations between employers and employees, nevertheless employment relations of certain groups of employees are subject to special legislation (administrative authorities, judges, armed forces, etc.). Moreover, the Labour Code does not apply to agreements on performance of functions concluded between business corporations and members of their bodies. These relations are conducted by the Act No. 90/2012 Coll, on the Business Companies and Cooperatives (Act on Business Corporations), as amended. For more details, please, see the section on Corporate Law.

## EMPLOYMENT CONTRACT AND OTHER LABOUR LAW CONTRACTS

An employee can work for an employer either based on an employment contract or based on agreements on work performed outside an employment relationship (so called work performance agreements), the later is allowed only for limited volume of time.

### ► Employment Contract

*It must be executed in writing, however the lack of the written form cannot be interpreted in detriment of the employee.*

An employment contract must include at least the type of work (job title) which the employee will perform for the employer, the place or places where the employee will perform the work and the date of commencement of the employment. Before the conclusion of the employment contract, the employer is obliged to provide the employee with information on the rights and obligation of the employee, employment conditions, etc.

An employment relationship shall last for an indefinite period of time, unless fixed term of its duration has been expressly agreed. Possibilities of fixed-term contracts are limited mainly by options of its prolongation. Generally, the fixed-term emplo-

ymment relationship should not exceed three years and can be prolonged only twice between the same contractual parties.

Besides other provisions, the employment contracts often include a probationary period. A probationary period shall be agreed in writing and may not be subsequently extended. Further, a probationary period may be concluded up to three consecutive months for regular employees and up to six consecutive months for chief officers. The probationary period may be agreed on the day which has been agreed as the day of commencement of the employment at the latest or on the day stated as the day of appointment of the chief officer. During a probationary period, the employer and also the employee may terminate the employment relationship due to any reason or without stating any reason. The termination notice within the probationary period has to be in writing and the employment relationship is terminated as of the delivery of the termination notice to the other contractual party or as of any later date specified in the termination notice.

Furthermore, a non-compete clause is also sometimes concluded. Non-compete clause (non-compete agreement) means, that an employee is obliged to undertake that for a certain period of time after the termination of his/her employment relationship, he/she shall not be engaged in a business activity which would be of competitive nature in respect of the former employer. The employer shall concurrently undertake to provide the employee with adequate monetary compensation for such period and this monetary compensation has to be at least in the amount of one half of the employee's monthly earnings for each month when the said obligation is fulfilled. Non-compete clause may include a contractual penalty so that in case the employee breaches his/her obligation, the employee shall pay such contractual penalty to the former employer. The employee's obligation is discharged on payment of the contractual penalty. The contractual penalty must be adequate to the nature and the significance of the obligation set in the non-compete clause.

## **AGREEMENTS ON WORK PERFORMED OUTSIDE AN EMPLOYMENT RELATIONSHIP**

There are two types of agreements on work performed outside an employment relationship. First of them is called agreement on work performance. The scope of work for which an agreement on work performance is concluded may not exceed 300 hours per employer in one calendar year. The said scope of working hours shall also include those hours of work for which a certain employee carried out some work for the same employer in one calendar year based on another agreement on work performance. The second type of agreement on work performed outside an employment relationship is called agreement on working activity. The scope of work per calendar year may in this case exceed 300 hours, however the average scope of work may not exceed one-half of normal weekly working hours.

Unless the Labour Code expressly provides otherwise, the provisions regulating performance of work in an employment relationship also apply to work carried out on the basis of an agreement on work performance or an agreement on working activity. However, this does not apply to provisions regulating annual leave, severance pay, termination of an employment relationship and a few other provisions, unless agreed in the relevant agreement. The main advantage of agreements on work performed outside an employment relationship is their flexibility. They can be easily concluded as well as terminated. Both parties may terminate the contract by notice of termination with 15 days long notice period and no specific reasoning or legal ground for unilateral termination is required. Both agreements on work performed outside an employment relationship are often used for holiday workers.

### **TERMINATION OF EMPLOYMENT**

Employment relationship can be terminated by mutual consent in writing, by notice of termination, by immediate termination, on the expiry of agreed period in case of temporary employment contract and by termination within a probation period.

The grounds for unilateral termination by employer are strictly limited to those listed in the Labour Code (e.g. the employer's undertaking or its part is closed down or relocated; the employee becomes redundant based on the decision of the employer or decision of the employer's competent body on the change of the activities (tasks) or to introduce other organizational changes (restructuring); the employee has lost, long-term, his capability to perform his current work due to his state of health; the employee does not meet the prerequisites prescribed by statutory provisions for performance of the agreed work, etc.

Under specific circumstances set in the Labour Code, the employer may terminate the employment relationship immediately (e.g. the employee has been sentenced, under a final verdict, for a willful criminal offence to a term of unconditional imprisonment of over one year or if an employee has been sentenced, under a final verdict, for a wilful criminal offence committed during performance of his working tasks, or in direct connection therewith, to an unconditional imprisonment of no less than six months or an employee has breached some obligation that arises from the statutory provisions and relates to his work performance in an especially gross manner).

In some cases also the employee may immediately terminate his/her employment relationship, however only under specific circumstances set in the Labour Code (e.g. if according to a medical certificate, the employee cannot perform his work any longer without a serious threat to his health and the employer has not transferred the employee to perform some suitable alternative work within 15 days of the submission of such medical certificate, or the employer has not paid employee's

wage or salary or compensatory wage or compensatory salary or some part of such wage or salary within 15 days of the maturity date).

Stricter conditions apply to collective dismissals or in case of trade union established within the employer. Special conditions apply also to employees holding specific positions in upper management. If agreed in the employment contract, the employees appointed to a position of chief officers may be recalled from the position/resign at any time without any reason. However, their employment relationship does not terminate by recall/resignation, and subsequently they must be either offered another job position, or their employment relationship can be terminated by notice for redundancy reasons.

The Labour Code prohibits giving notice of termination to an employee during the “protection period” (while the female employee is pregnant or is on maternity leave, the employee cannot perform the work due to his/her health condition, the employee is released to exercise a public office, etc.). In case of the immediate termination, the employer cannot immediately terminate an employment relationship with a pregnant employee, a female employee who is on maternity leave, or a male or female employee who is on parental leave.

In case of termination by notice, the employment relationship terminates after expiry of two month (or longer, if agreed in writing) notice period which is the same for both parties and shall start running on the first day of the calendar month following the delivery of the notice.

Invalidity of termination of an employment relationship by notice, by immediate dismissal or resignation, by notice during the trial period or by agreement may be claimed by both parties, i.e by the employer and also by the employee, before the competent court within two months as of the date when the employment relationship should have terminated.

On termination of an employment relationship, an employee whose employment relationship is terminated by notice given by his employer for certain legal grounds (employer is closing down, relocating or the employee becomes redundant) or by agreement for the same reasons is entitled to receive from the employer severance pay (redundancy payment) at least in the amount equal to:

1. Once his average (monthly) earnings where an employment relationship to the employer lasted less than one year
2. Twice his average earnings where an employment relationship to the employer lasted at least one year and less than two years
3. Triple his average earnings where an employment relationship to the employer lasted at least two years.

Collective bargaining is carried out in a wide scope of fields on a national or industry-wide level as well as on a regional or local level. Collective Bargaining agreements apply only to those employers who are members of the respective employer organization and to those employees on behalf of which the trade union concluded the agreement.



## **COLLECTIVE BARGAINING AGREEMENTS**

Collective bargaining is carried out in a wide scope of fields on a national or industry-wide level as well as on a regional or local level. Collective Bargaining agreements apply only to those employers who are members of the respective employer organization and to those employees on behalf of which the trade union concluded the agreement.

## **WORKS COUNCILS**

Works councils can be formed in all companies and have from 3 to 15 members. The members are elected for three years and do not need to be union members. The rights of the works council range from information rights to co-determination rights in organizational, social, security and other matters.

## **WAGES, WORKING HOURS, PAID LEAVE, PUBLIC HOLIDAYS, EMPLOYEE BENEFITS**

Wages of non-governmental employees may be agreed in the employment contract or determined by the employer. The wages must always respect the minimum monthly wage determined by governmental regulation. As of 1. 1. 2018, the minimum monthly wage is CZK 12,200 (approx. EUR 470) per month. This amount has increased considerably since 2013 due to a change of a political situation and it is possible that this amount will increase after 2017 parliamentary elections given the fact that this issue is currently one of the major topics of the campaign.

There is also determined “guaranteed wage”, which assures the height of wage for some work positions. Any discrimination in pay is prohibited.

Besides the basic wages, the employee may become entitled to different bonus wage for overtime work, work on public holiday, work during weekend, work at night or in difficult conditions.

The length of standard work-week shall be 40 hours. Part-time work may be agreed, usually corresponding to half or third of standard work-week. A compulsory rest period of at least 0.5 hours applies to employees working over 6 hours (4.5 hours for young employees). These breaks are not included in working hours. Overtime work may be ordered only exceptionally by an employer up to 8 hours a week and up to 150 hours a year (more can be agreed in writing). In case of overtime work, an employee is entitled to compensation of his/her average earnings and to a bonus wage; alternatively, employer and employee may agree that the employee will be provided with time off instead of the bonus wage.

Employers must provide the employees with four weeks of annual paid leave as a minimum and in case of governmental employees or a specific group of employees engaged in particularly hard work with five weeks of annual paid leave. Collective

bargaining agreements as well as individual employment contracts may increase the number of leave days (often up to five weeks or more per year). An employee is entitled to receive leave with pay equal to his/her average earnings during leave.

The Czech Republic has the following public holidays during which the work performance usually cannot be required: New Year's Day (January 1), Big Friday, Easter Monday, Labour Day (May 1), Liberation Day (May 8), Cyril & Methodius Day (5 July), Jan Hus Day (6 July), Statehood Day (September 28), Czechoslovak Independence Day (October 28), Struggle for Freedom Day (November 17), Christmas (December 24-26).

The employer must ensure occupational safety and health protection of employees at work with regard to risks which might endanger his employees' life and health during performance of work.

Employees are often motivated to better performance by various job benefits. The most common benefits for the employees in the Czech Republic are: financial rewards (13th salary, performance bonuses etc.), professional trainings, language courses, option of home office, additional days off (extra leave days, study leave, sick days), flexible working hours, meal vouchers, contribution to insurances (e.g. life insurance or retirement pension insurance) and also provision of company's car for personal purposes (this benefit is subject to income tax, for more detail, please see the part Tax Law).

## **SOCIAL CONTRIBUTIONS AND INCOME TAX**

The Czech Republic has a compulsory social security system that provides for retirement pensions, contribution to state employment policy and illness allowances. Social security contribution and health insurance are paid separately. All the contributions are paid partly by an employer and partly by an employee. An employer withholds an employee's share of the contribution from his wages.

The personal income tax in the Czech Republic is paid by an employee at a flat rate of 15 % applicable on a super-gross salary (gross salary increased by 34 % of employer part of Czech obligatory social security and health insurance contributions). For more information, please, see the part Tax Law.

# Czech Republic | REAL STATE

## TYPES OF OWNERSHIP

A natural or legal person may be the sole owner of real estate or several owners may hold the real estate jointly. In case of general co-ownership, each co-owner owns an ideal (not physical) part of the real estate. Under Czech law, each ideal part of real estate is treated as if it was owned by a sole owner, so the co-owner can dispose with its share, i.e. can sell or encumber it without the consent of other co-owners. However, each co-owner is limited by the statutory pre-emptive right of other co-owners. Such pre-emptive right may be waived with effects for legal successors. All decisions related to disposal of the real estate as whole must be made jointly by all co-owners. In questions of use and administration, the co-owners decide by majority (with a few exceptions).

Special cases of joint ownership are the joint ownership of spouses and flat co-ownership. Each of the spouses owns the whole real property in joint co-ownership, but in case of extraordinary disposals, he or she should obtain the consent of the other spouse with such disposal. If one of the spouses refuses to give consent without a serious reason and contrary to the interests of the spouses, family or family household or is unable to express his/her will, the other spouse may apply to a court to substitute the consent of his spouse.

Flat co-ownership is a special legal institute which allows for ownership of separate parts of buildings. The ownership of a building is usually transformed to flat co-ownership by a legal act of the owner or co-owners. The building is then divided into two types of premises - units (which may be either of residential or non-residential nature) and so called common premises which include all bearing structures, windows, balconies, etc. A natural or legal person that becomes owner of a unit becomes at the same time a co-owner of the common premises and of the plot underneath the building. The share on the common premises and on the plot is inseparably connected with the ownership of the unit, i.e. it cannot be transferred separately.

## ASSOCIATION OF UNIT OWNERS

The purpose of the association of unit owners is ensuring the administration of the building where the separate flats (units) are located. The association may not pursue business activities on its own. Its capacity to act is limited to the purpose of administration of the building and the plot. For example, one of the main aims of the association is to ensure cleaning and repairs of the common premises.

The association of unit owners is founded by the approval of the Articles of Association by its members and established by its registration in the relevant register. After the building is divided to flats (units) by a legal act of the owners, the association of the unit owners must be established in case of a building where there are at least five units of which at least three are owned by different owners. If the association of unit owners is not established in such case, the Property Register refuses to register any transfer of ownership right regarding the units, until the association is established.

The supreme body of the association of unit owners is the Assembly consisting of all unit owners, each of them having number of votes equal to the percentage of his/her share in the common areas. The Assembly is competent to adopt decisions in areas specified by the Civil Code; these are mainly the most important issues regarding the administration of the building (e.g. approving the type of services and the amount of advance payments to pay these services). Other issues are dealt with operatively by the Committee of the association or the Chairman of the association, elected by the Assembly. To adopt a decision of the Assembly, unit owners having majority of votes have to be in favour of the proposal and at the same time, presence of unit owners having the majority of votes is necessary. The Article of Association may stipulate for a higher quorum for adopting a decision. Unit owners may request court review of the Assembly's decision within three months from the day the decision has been adopted.

### **PRE-EMPTION RIGHT OF DIFFERENT OWNERS OF THE PLOT AND BUILDING**

Through 1950 to 2014, a plot of land and a building constructed on it were conceived as two separate legal things. In 2014, the principle pursuant to which any building with solid foundations forms an integral part of the land on which the building is constructed was adopted. In order to deal with the existing different owners of land plots and buildings, the new Civil Code established a mutual pre-emption right of an owner of a land plot to the building situated on the land plot and vice versa.

### **PROPERTY REGISTER**

In order to provide publicity to legal relations related to real estate, the Property Register discloses main legal relationships concerning land and certain constructions. Property Register is kept by cadastral authorities. Every person is entitled to inspect the Property Register; the Property Register is even, in a limited extent, available online free of charge on <http://nahliznidokn.cuzk.cz/>. Extracts from the Property Register may be purchased especially at notaries, municipal authorities, cadastral authorities and Czech Post. The Property Register is divided into sections by cadastral areas and each owner has its own ownership portfolio in the Property Register.

An ownership portfolio is made up of several sections: Section A provides information about the owner, Section B provides information on the registered real estate, in Section B1 other rights in the benefit of the real estate are registered (such as easements), Section C provides information about liens on the real properties such as mortgages or other encumbrances (e.g. easements) or limitations in disposition, Section D may contain other relevant information, usually not directly related to ownership title and its limitations, Section E lists the acquisition titles based on which the ownership title to the real properties was registered to the Property Register, Section F provides information on the quality of agricultural land.

Any change to the legal relations concerning real estate registered in the Property Register is marked in the relevant ownership portfolio on the day following the day the relevant application was delivered to the relevant cadastral authority to assure the highest possible publicity. The tendency is to protect those who acquire any right relying on the contents of the Property Register; however, the genuine owner has its ways to protect its ownership right against fraud. In case the genuine owner claims to have his right affected by a registration in Property Register without a legal cause in favour of another (e.g. in case of a fraud), he/she is entitled to claim the deletion of such registration by a mean of a declaratory action filed with the relevant court. If the genuine owner asks the cadastral authority to note the existence of such dispute in the Property Register within one month from the date on which the owner learned of the registration, the genuine owner is protected against the effects of further dispositions with the real estate until his ownership is confirmed by the court's decision.

## TRANSFER

Real property can only be transferred by written agreements. The signatures must be on the same document and should be notarized (otherwise, the competent cadastral authority will have to verify the authenticity of the signatures personally). If the property is registered in the Property Register, the transfer becomes effective by the registration in the Property Register. Such registration is made based on an application of any of the parties to the contract on prescribed form. The registration of ownership right is subject to a fee in the amount of CZK 1,000 (approx. EUR 38.40)

Payment of the purchase price is usually secured through escrow (notarial, bank or with an advocate), the monies being released after the registration. Transfer of the real estate is subject to a transfer tax (4 % from the purchase price/value of the real estate) burdening the purchaser.

Pursuant to the Act No. 253/2008 Coll., on selected measures against legitimisation of proceeds of crime and financing of terrorism, as amended, real estate agents are obliged to check up on its client when arranging the sale of the real property for

purchase price higher than EUR 10,000. The check-up shall consist of gathering information on intended purpose of the transaction, beneficial owner of the legal entity which is a party to the transaction and a source of the money or other property affected by the transaction.

## **MORTGAGES AND CHARGES**

Mortgages or liens are rights in rem over real estate securing payment to a creditor (usually, but not exclusively a bank). The creditor of a lien on real property is, in case of default with payment by the debtor, entitled to claim compulsory enforcement through sale of the real property, usually in public auction. Establishing a mortgage over real property requires the same requisites as its transfer (written agreement, registration in the Property Register). The lien expires once the secured receivable is repaid. Real properties may also be charged by pre-emptive rights obliging the owner to make the first offer for sale to the entitled party from the pre-emptive right.

Easements, on the other hand, oblige the owner of the encumbered real property to suffer certain action of the entitled party or even provide certain performance (e.g. the right of the third person to use a footpath across the encumbered land plot). Easements can be established in favour of a real property or a person (natural or legal).

## **RESTRICTIONS ON ACQUISITION**

Under Czech law, there are no more distinctions between Czech and foreign buyers of real estate. Any legal or natural person is entitled to buy real estate. Restrictions on transfer may be imposed either by agreement of the parties (i.e. a pre-emptive right), by applicable legal regulations (pre-emptive rights of co-owners or of a flat tenant in case of first transfer, etc.) or decisions of competent bodies (preliminary injunction of a court, commencement of enforcement in execution against a debtor, etc.).

## **LEGAL PROTECTION FOR BUYERS AND SELLERS**

Czech law gives no special protection to buyers or sellers of real properties, however, according to the Civil Code, the buyer has the right to apply hidden defects within a period of 5 years since the transfer. Those involved in property transactions will also usually use a solicitor to represent their interests. It is the job of the buyer's solicitor to ensure that the property being bought is free from undisclosed restrictions or obligations (usually based on examination of the extract from the Property Register and previous legal title) and that it is validly transferred.

## **RESTRICTIONS ON DEVELOPMENT**

To allow for development, the land must be designated for construction in the applicable zoning plan of the respective municipality. Zoning plans are adopted

by municipal councils and specify how different parts of areas are to be used and developed. Before land can be developed, the relevant public law regulation requires obtaining planning and building permit from the building authority. Some types of minor development are permitted without planning permit. Obtaining the permits for bigger projects may be complicated or prolonged due to number of objections raised by owners of neighbouring plots in respective proceeding as some of the neighbouring owners often misuses the protection of their rights provided by construction laws. Issued building and planning permits may be subject to a court review.

\*Agricultural land is subject to special protection and its development requires special permit and payment of a fee.

## LEASES

Czech law distinguishes between leases for private housing accommodation (flat leases) and leases for business purposes. Regulation of flat leases is highly protective on tenants and terms of lease contract for flat may not differ in detriment of the lessee from the provisions stipulated by the Civil Code. The possibilities of landlords to terminate the flat leases are limited. The housing market is still to a certain extent deformed by a high number of lease agreements concluded for indefinite period of time in the past without any indexation clause. The Civil Code now includes a procedure how to achieve the increase of the rent to market level.

Proper specification of the subject of lease is essential for the validity of the contract. The lease contract shall also specify the period of time, for which the lease is being concluded; it is either a definite period of time (the lease ceases to exist at the end of agreed period of time) or an indefinite period of time (the lease continues to be valid until it is terminated by an agreement or a notice of one of the parties). In case of tenant's death, the lease is *ex lege* transferred to a relative of the tenant who shared a household with the deceased tenant provided that the relative does not have his/her own flat; such lease lasts for maximum of two years from the transfer. Unless specified differently by the lease agreement, the lease is prolonged (for a maximum of two years) if the tenant continues to use the flat for period of at least three months after the lease expired and the landlord does not request him to leave the flat.

As concerns the possibility of lease contract termination, the landlord is allowed to unilaterally terminate the lease only for specific reasons set out by the Civil Code with notice period of three months (for example in case the flat is to be vacated because it is necessary in the public interest to dispose of the apartment or the building in which the apartment is located in such a way that any use of the apartment will be impossible). In some serious cases, the landlord may terminate the lease with immediate effect, for example when the tenant is in default with rent payments for more than three months or if the tenant is seriously damaging the flat. The landlord must specify the reason of the termination in the notice and must

advise the tenant about his right to object against the notice and right to apply for court review of the lawfulness of the termination, otherwise the termination is invalid.

Landlord is not allowed to provide for a contractual penalty for breach of tenant's obligation in a lease agreement. In case of tenant's default with rent payment, the landlord is entitled to statutory late-payment interest. Landlord may ask tenant to provide a financial deposit in maximum amount of three-month rent which may be used to satisfy landlord's financial claims against the tenant. After the end of the lease, the balance of the deposit shall be returned to the tenant.

In case of need for repairs of the leased flat, the costs of the repairs are divided between the landlord and the tenant as set out in the Governmental Decree No. 308/2015 Coll., on the Definition of the Term Regular Repair Related to Use of the Flat. The tenant bears all costs of regular repairs, specified in the governmental decree, up to CZK 100 (approx. EUR 3.84) per square meter of floor area per year.

## LEASE OF BUSINESS PREMISES

The respective regulation of the Civil Code applies only to lease of premises for the purpose of conducting business in such premises, regardless of whether or not the purpose of the lease is stated in the lease contract.

A lessee is not allowed to perform other activities than those agreed upon in the lease agreement or change the manner or conditions of the business activity if such a change would deteriorate the conditions in the immovable thing or be harmful to the lessor or other users of the immovable thing beyond a reasonable degree.

Upon consent of the lessor, the lessee may install signboards, posters and similar signs on the business premises. After the lease has ended, the lessee shall remove installed signs and restore the affected part of the real estate to its original conditions.

Lessee may terminate the lease if he/she loses the eligibility to perform business activities for which the business premises are intended or if the leased premises cannot be used for performance of the business activities they were intended for and the lessor fails to provide the lessee with adequate replacement premises or if the lessor materially breaches his duties towards the lessee.

Lessor may terminate the lease if the leased real estate is to be removed or reconstructed so that the further use of the premises is not possible and the lessor could not have foreseen it when concluding the contract or if the lessee materially breaches his duties despite having been requested to remedy the situation by the lessor (e.g. lessee being more than one month in default of the rent payment). The notice period is in all cases three months, unless agreed otherwise.



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Denmark

KLAR Advokater

# KLAR Advokater

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Denmark

📍 Ny Vestergade 7D, 1471  
København K, Denmark

☎ +45 72 28 91 01

✉ +45 72 28 91 91

info@etiennelaw.com

www.klaradvokater.dk

## General Information

KLAR Advokater is a Danish commercial and litigation firm based in Copenhagen.

We combine traditional attorney's virtues such as high ethics, discretion, thoroughness and thoughtfulness with clear, comprehensible and qualified counseling customized to the client's needs.

Our client base comprises listed international business enterprises as well as small and medium-sized companies. Our business focus is in on major enterprises' mid-size cases and transactions, which we give all the partner attention they need in order to get solved well quickly.

Several of our lawyers have worked as in-house legal counsel at large international companies. Such experience gives us a unique insight into the clients' needs and expectations from their external legal counsel.

It is our constant aim that KLAR would also be our preferred law firm if we were the clients.

## The Name

The Danish word KLAR means ready, comprehensible, clear, transparent and prepared. It is our mission to always provide advice to our clients that is KLAR in every sense of the word:

We are fast and easily accessible  
We give qualified and lucid advice  
Comprehensible prices and business conditions, including in relation to billing

Transparent work processes – our clients have online access to check on the status of their cases and we are happy to work on the case together with our clients and at their offices

Our work always makes a clear difference to our clients

## Areas of Practice

KLAR Law Firm provides legal services within most areas of business law, but our primary focus areas are:

Corporate & Commercial  
Litigation and Arbitration  
Mergers and Acquisitions  
Real Estate

# Denmark | CORPORATE LAW

In Denmark one can choose between a range of different legal entities for one's business. These vary from small entities with no share capital to companies with a minimum share capital of DKK 500.000. The most common entity types are the ApS (Private Limited Company) and A/S (Public Limited Company) entities. However many small businesses with only one owner operate as personal one-man businesses.

The two tables below illustrate the most common entity types, and list the most relevant characteristics of each type. Table 1 describes types of limited liability entities and Table 2 describes other types of entity forms, including a limited partnership. Each type of entity is further described below the tables.

<i>Table 1</i>	<b>A/S (Public Limited Company)</b>	<b>A/S (Public Limited Company)</b>	<b>A/S (Public Limited Company)</b>	<b>A/S (Public Limited Company)</b>
<b>Use</b>	Middle-sized and large companies (may be listed on the stock exchange, though this is not mandatory)	Small and middle-sized companies – primarily used for consultancy companies	Small and middle-sized companies	Small companies and entrepreneurs. May be owned by natural persons or other companies
<b>Minimum capital requirement</b>	DKK 500,000 (only 25 % of the total capital has to be deposited)	DKK 500,000 (only 25 % of the total capital has to be deposited)	DKK 500,000	Between 1 DKK and DKK 49,999
<b>Liability</b>	Limited to the value of the share capital	Limited to the value of the share capital of the mother company and the full capital of the general partner	Limited to the value of the share capital	Limited to the value of the share capital
<b>Management</b>	Either: A Board of Directors with minimum 3 persons and an Executive Board with minimum 1 person Or: A Board of Supervisors with minimum 3 persons and an Executive Board with minimum 1 person	Either: A Board of Directors with minimum 3 persons and an Executive Board with minimum 1 person Or: A Board of Supervisors with minimum 3 persons and an Executive Board with minimum 1 person	Either: A Board of Directors and an Executive Board with minimum 1 person Or: An Executive Board with minimum 1 person	Either: A Board of Directors and an Executive Board with minimum 1 person Or: An Executive Board with minimum 1 person. This is the most common form of management in an IVS

<i>Table 1</i>	<b>A/S (Public Limited Company)</b>	<b>A/S (Public Limited Company)</b>	<b>A/S (Public Limited Company)</b>	<b>A/S (Public Limited Company)</b>
<b>Change in articles of association</b>	Depends on what is agreed in the articles of association. If nothing is agreed: 2/3 of the submitted votes and 2/3 of the share capital represented on the general meeting. Some extensive changes requires a higher share of votes	Depends on what is agreed in the articles of association. If nothing is agreed: 2/3 of the submitted votes and 2/3 of the share capital represented on the general meeting. Some extensive changes require a higher share of votes	Depends on what is agreed in the articles of association. If nothing is agreed: 2/3 of the submitted votes and 2/3 of the share capital represented on the general meeting. Some extensive changes require a higher share of votes	Depends on what is agreed in the articles of association. If nothing is agreed: 2/3 of the submitted votes and 2/3 of the share capital represented on the general meeting. Some extensive changes require a higher share of votes
<b>Share classes</b>	Different classes (A-, B-, C- etc.) One class can have no right to vote while other classes do	Different classes (A-, B-, C- etc.) One class can have no right to vote while other classes do	Different classes (A-, B-, C- etc.) One class can have no right to vote while other classes do	Different classes (A-, B-, C- etc.) One class can have no right to vote while other classes do
<b>Shareholders agreement</b>	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties
<b>Accounting</b>	Annual audit may be mandatory, depending on company's turnover	Annual audit may be mandatory, depending on company's turnover	Annual audit may be mandatory, depending on company's turnover	Annual audit may be mandatory, depending on company's turnover
<b>Company tax</b>	Corporate income tax 22 %*	All income is taxed as personal income / income in the shareholder companies	Corporate income tax 22 %*	Corporate income tax 22 %*
<b>Tax on capital gains</b>	27 % up to DKK 51.700 42 % in excess of DKK 51.700	Either: Personal income tax if a person is partner Or: Corporate 22 %* if a company is partner	27 % up to DKK 51.700 42 % in excess of DKK 51.700	27% up to DKK 51.700-42% in excess of DKK 51.700
<b>Registration</b>	Must be registered with the Danish Business Authority	Must be registered with the Danish Business Authority	Must be registered with the Danish Business Authority	Must be registered with the Danish Business Authority
<b>Legislation</b>	The Danish Companies Act	The Danish Companies Act	The Danish Companies Act	The Danish Companies Act

<i>Table 2</i>	<b>I/S (Partnership)</b>	<b>K/S (Limited Partnership)</b>	<b>Branch</b>	<b>Sole proprietorship</b>
<b>Use</b>	Small companies (at least two owners who can be either private persons or limited liability companies)	Small companies (at least two owners, either private persons or limited liability companies)	Used for representing the head office when this is located in another country (mainly in the EU)	Small businesses with only one owner (owner has to be a private person)
<b>Minimum capital requirement</b>	No minimum requirement	No minimum requirement	No share capital (No minimum requirement)	No minimum requirement
<b>Liability</b>	Unlimited, joint and several liability	Limited to the value of the share capital of the general partner company/companies. Joint and several liability if there is more than one.	The head office of the branch is fully liable according to the rules of its country	Unlimited liability. The owner is personally liable with his/her entire fortune
<b>Management</b>	No regulation, if nothing is agreed each partner can legally enter into binding obligations on behalf of the partnership.	Management is regulated by the general partner/partners. If nothing is agreed, all general partners can legally enter into binding obligations on behalf of the partnership together.	No requirements	No requirements
<b>Change in articles of association</b>	Method of changes is as agreed upon in the articles of association	Method of changes is as agreed upon in the articles of association	No articles of association	No articles of association
<b>Share classes</b>	Can be agreed upon in the articles of association	To be agreed upon in the articles of association	No share capital	No share capital
<b>Shareholders agreement</b>	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties	No shareholders agreement	No shareholders agreement
<b>Accounting</b>	No requirements	No requirements	A copy of the financial statements of the head office must be filed	No requirements
<b>Company tax</b>	All income is taxed as personal income / income in the shareholder companies	All income is taxed as personal income / income in the shareholder companies	Corporate income tax 22 %*	All income is taxed as personal income
<b>Tax on capital gains</b>	Must be registered with the Danish Business Authority	Must be registered with the Danish Business Authority	Must be registered with the Danish Business Authority	Must be registered with the Danish Business Authority
<b>Registration</b>	Personal income tax	Personal income tax	The branch is taxed as a Danish company by 22 %*	Personal income tax
<b>Legislation</b>	Executive Order on the Act on Certain Commercial Undertakings	Executive Order on the Act on Certain Commercial Undertakings	The Danish Companies Act	Not governed by company legislation

## CHOICE OF LEGAL ENTITY

Before starting a business the preferred type of legal entity must be considered. The choice can depend on many different factors but the most common factors are one or more of the following:

1. Liability
2. Taxation of the company and the owners
3. Sufficiency of establishing a branch (foreign companies only)
4. Start-up capital and running costs (share capital, registration costs...)
5. Overall reputation in the market

## TYPES OF COMPANIES

As earlier mentioned there are several different types of legal entities. The types most commonly chosen for medium-sized and large companies are either a private limited company (ApS) or a public limited company (A/S). These two types of company are regulated by the same rules but differ in some aspects, as described below:

### ► **A/S (Public Limited Company)**

*Most large companies in Denmark (and all stock-exchange listed companies) are established as an A/S (Public Limited Company), which is a well-reputed entity type. The total required share capital is minimum DKK 500,000. The shareholders' liability is limited to their investment in shares.*

*An A/S must have either a Board of Directors or a Board of Supervisors with at least three members. Furthermore the A/S must have an Executive Board with at least one member (the managing director).*

*An A/S pays 22 %\* in corporate taxes based on the company's yearly profit. The shareholders return on shares and share premiums are subject to taxation as follows: In 2017, the first DKK 51.700 are taxed by 27 % and share income exceeding DKK 51.700 is taxed by 42 %.*

*An A/S is obliged to publish its annual accounts and may be subject to annual audit depending on its turnover.*

### ► **ApS (Private Limited Company)**

*Many small and middle-sized companies choose to run their business as an ApS, which requires a share capital of DKK 50,000. The shareholders' liability is limited to their investment in shares.*

An ApS must have a managing director and may choose also to have either a Board of Directors and a Supervisory Board.

The lower amount of required share capital makes this entity type very attractive to founders who either cannot or will not tie up more capital than necessary, but still wish to limit their liability risks.

An ApS pays 22 %\* in corporate taxes based on the company's yearly profit. The shareholders return on shares and share premiums are subject to taxation as follows: In 2017 the first DKK 51.700 are taxed by 27 % and share income exceeding DKK 51.700 is taxed by 42 %.

An ApS is obliged to publish its annual accounts and may be subject to annual audit depending on its turnover.

#### ► P/S (Limited Partnership Company)

A P/S is a hybrid between an A/S (Limited Liability Company) and an I/S (Partnership). This corporate structure is primarily chosen by companies owned by persons who work in the company (partners), such as law-firms, accountants and other consultancy companies.

By choosing the P/S the liability is limited to the shareholders' share capital, which is required to be at least DKK 500,000 in total. However, at least one participant acts as a general partner whose liability is unlimited (he is liable with his all of his/her personal capital), and there is also at least one limited partner, whom is only liable with his value of shares in the P/S. Both the general partner and the limited partner can be a physical person or an ApS or an A/S. Usually the general manager is either an A/S or an ApS because these companies have a limited liability.

The P/S does not pay corporate taxes, but instead the owners' (who can be either physical persons or companies) profit is taxed as income, for which reason the owners can deduct their profit from the P/S from other negative income.

A P/S is obliged to publish its annual accounts and may be subject to annual audit depending on its turnover.

#### A/S (Public Limited Company) vs. ApS (Private Limited Company)

An A/S is subject to the same rules as an ApS but differs mainly concerning the following conditions:

- Minimum share capital  
A/S: DKK 500,000 (only 25 % has to be deposited but the remain capital must be paid by demand)  
ApS: DKK 50,000
- Shares for public subscription (e.g. on a stock exchange)  
A/S: Yes  
ApS: No
- Management  
A/S: Management Board/Board of Supervisors + Executive Board  
ApS: Management Board and/or Executive Board

#### P/S (Limited Partnership Company) vs. A/S (Public Limited Company)

A P/S is subject to the same rules as an A/S but differs mainly concerning the following conditions:

- Shares for public subscription (e.g. on a stock exchange)  
A/S: Yes  
P/S: No
- Taxation: A/S: Yes  
A/S: The company is taxed by 22 %\* - the shareholders are taxed with 27 % up to DKK 51.000 and with 42 % in excess of DKK 51.7000 : In 2017 the first DKK 51.700 are taxed by 27 % and share income exceeding DKK 51.700 is taxed by 42 %.  
P/S: Personal income tax if a person is partner (income is deductible in negative income)  
Or: 22 %\* corporate tax if partner is an A/S or an ApS (income is deductible in negative income)
- Ownership and influence  
A/S: Owned by shareholders only  
P/S: Owned by shareholders and a general partner, who must have a significant influence on the company's management.



*Both A/S, ApS and P/S are required to file their articles of association with the Danish Business Authority and any changes have to be filed within 14 days from the start-up date.*

► **IVS (start-up company)**

*An IVS is a rather new form of company with many advantages. Different from an ApS, the minimum capital requirement for an IVS is DKK 1.00. In return the IVS has to build up its capital by saving up at least 25 % of the annual profit of the company, until the total equity amounts to DDK 50.000. Hereafter the IVS can re-register as an ApS if the shareholders wish to. The capital share in an IVS has to be paid in cash as opposed to other company forms.*

*Another advantage to the IVS is the limited liability. The company is only liable with the company capital, meaning that the owners of an IVS are not personally liable for the company's debt.*

*An IVS has to make an annual report cf. the Danish Financial Statements Act and report it digitally to the Danish Business Authority.*

**IVS (start-up company) vs. ApS (Private Limited Company)**

A P/S is subject to the same rules as an A/S but differs mainly concerning the following conditions:

- Minimum capital requirement  
 IVS: minimum 1.00 DKK but no higher than 49.999 DKK.  
 ApS: DKK 50.000
- Saving of profit  
 IVS: Required to save up at least 25% of the annual profit until the capital of the company reaches DKK 50.000.  
 ApS: No requirements.

► **I/S (Partnership)**

*An I/S can be the easiest way to start a business that will have more than one owner. An I/S can be owned by either physical persons, by companies or by a mixture of persons and companies.*

*All owners, be they persons or companies, are liable for any claims. However, if the owner is a limited liability company, e.g. an ApS (private limited company) this owner will only be liable with the share capital of the owner company. On the other hand, when the owner is a physical person they are liable with their whole personal capital. As well as having unlimited liability, the owners of an I/S are jointly and severally liable towards any claims.*

*The income of an I/S is taxed in the same way as a P/S (Limited Partnership Company): as either personal income (when the owner is a physical person) or as corporate income (when the owner is a company).*

*An I/S is not obliged to submit a registration to the Danish Business Authority regarding its start-up. However the I/S business is obliged to submit a VAT registration if turn over reaches or exceeds DKK 50.000 a year. Finally, an I/S is not obliged to publish its annual accounts.*

**► K/S (Limited Partnership)**

*A K/S (Limited Partnership) is an entity type used primarily by investment companies. A K/S has at least one general partner and one limited partner.*

*In a K/S the general manager/managers are liable with all of their capital and the limited partners' liability is limited to their investment in the K/S. Both the general partner and the limited partner can be a physical person or an ApS or an A/S. Most often, the general manager is either an A/S or an ApS because these companies have a limited liability.*

*The K/S does not pay corporate taxes, but instead the owners' (who can be either physical persons or companies) profit is taxed as income. This means that the owners can deduct their profit from the K/S from other negative income. If there are more than 10 participants in the K/S, it is not possible to deduct positive income from negative income.*

**BRANCH**

A company from another country in the European Economic Area can establish a branch in Denmark instead of establishing an actual company. A branch is doing business at the risk and responsibility of the foreign company and is therefore not a legal entity in and of itself.

A branch is taxed as a limited company at a rate of 22 %\* but does not require any share capital to start up. A branch is obliged to mention the word "filial" (meaning "branch") and the full name of the company for which it is doing business as part of its registered name.

**SOLE PROPRIETORSHIP**

A Sole proprietorship is a business with only one natural person as its owner. There are no minimum requirements to the startup capital, but the owner is personally and unlimitedly liable for the company's loss. There are no legal requirements for management and publication of accounts.

**THE CENTRAL COMPANY REGISTER (CVR)**

CVR is the government's master register for company details and contains information about all companies in Denmark. The CVR contains information about all companies with a duty to register as well as associations that voluntarily have elected to register. All companies in the CVR register have a unique identification number – a CVR number. A CVR number always has eight digits. To search for a Danish company visit [www.cvr.dk](http://www.cvr.dk)

\* The corporate tax rate is currently 22 % in 2017.

# Denmark | TAX LAW

## CORPORATE RESIDENCE

As a main rule European companies and foreign companies which have a management effectively placed in Denmark or that carry on business activities through a branch in Denmark are subject to corporate tax in Denmark.

## DIFFERENT COMPANY TYPES

### ► Limited liability companies

*Most Danish limited liability companies, such as A/S (Public Limited Liability Company) and ApS (Private Limited Liability Company) are subject to corporate taxation.*

### ► Partnerships and limited partnership companies

*In most cases partnerships and limited partnership companies are transparent in terms of tax which means that only the owners/partners are subject to tax and not the company itself.*

### ► Branches

*Foreign companies with a branch in Denmark are, with regard to the income deriving from the branch, subject to corporate taxation in Denmark. Income from a Danish company's foreign branch is under certain conditions not subject to Danish corporate taxation.*

## CORPORATE TAXATION

Danish corporation tax is currently set at a flat rate of 22 %\*. Business expenses and depreciations are tax deductible, which means that only the corporations' net income is to be taxed. Furthermore, Danish companies can carry losses forward for an unlimited period, so that these can be deducted from later positive net incomes.

## DEPRECIATION

As a main rule companies' expenses are tax deductible.

Machinery and equipment used for the operation of the company is depreciated with 25 %. However the depreciation of assets with a long life span, such as airplanes, ships etc. is being gradually reduced from 25 % to 15 % in the period from 2008 until 2016. Infrastructure facilities are depreciated with 7 % and buildings are as a rule depreciated by up to 4 %. Goodwill and other intangibles are depreciated equally over 7 years.

## TAX RETURNS

Companies are obliged to submit a tax return for each fiscal year. However, small and medium-sized companies are exempted from this obligation and only have to submit financial and operating data via the tax authorities' homepage ([www.skat.dk](http://www.skat.dk)). An English version is also available.

Furthermore, companies are obliged to pay taxes on account, which are charged every 20 March and 20 November.

## CAPITAL GAINS

Capital gains from a subsidiary or group company are exempted from tax. As a main rule capital gains deriving from bonds and debts owned by a company are taxed as corporate income tax at a rate of 22 %.

Shareholders who are not resident in Denmark are as a main rule not subject to Danish tax for capital gains on shares in Danish companies.

## DIVIDENDS

As a main rule, a parent company is exempted from tax on dividends from a subsidiary or group company. If the parent company is a foreign company, it is usually a condition for the tax exemption that the distributing company is not able to deduct the dividends from its taxable income.

## JOINT TAXATION

Danish companies are taxed jointly with their Danish group companies or branches. Negative income of one company or branch can be deducted in positive income of another affiliated company or branch.

It is optional for a Danish company to choose whether to be jointly taxed with a foreign affiliated company/branch or not. If the companies choose to be jointly taxed this taxation must include all companies and branches within the group globally and joint taxation must typically apply for a 10-year period.

## TRANSFER PRICING

The Danish rules on Transfer Pricing are based on the OECD Transfer Pricing Guidelines. Transactions between affiliated companies must comply with the arm's-length principle which implies that products or services must be transferred at the relevant market price. Some groups may be subject to documentation requirements.

## THIN CAPITALISATION

If a group's controlled debts exceed DKK 10 million and the debt to equity ratio exceeds 4-to-1 at the end of the fiscal year, thin capitalisation rules may apply.

## CFC TAXATION

Financial companies (companies where more than 50 % of the income is financial and where at least 10% of the assets are financial) controlled by a Danish company are subject to CFC Taxation. If a company holds the majority of the voting rights in a subsidiary company it is considered as a controlling company. According to the CFC taxation, the total income of the subsidiary is subject to Danish tax.

## DOUBLE TAXATION RELIEF

If a company is subject to taxation in both Denmark and another country, double taxation may be relieved in accordance with a tax treaty, if such a tax treaty has been entered into between Denmark and the other relevant country. If a company is subject to double taxation in Denmark and a country with which Denmark has not entered a tax treaty with, a tax credit may be granted according to specific Danish rules.

## PERSONAL TAXATION

### ► Income taxes

*Persons who are tax liable in Denmark pay up to 55 % in income taxes depending on their level of income and right to tax deductions. As an indicator of the taxation level all income up to DKK 479.600 in 2017 per year is taxed at approximately 42 % and income exceeding DKK 479.600 in 2017 is taxed at a marginal tax rate of approximately 55 %.*

### ► Relaxed taxation of foreigners

*In spite of the high level of income tax in Denmark, foreigners who move to Denmark to work may apply for favourable income taxation. In Danish this taxation is called "Forskerordningen" (i.e. the "scientist arrangement") and contains a flat rate income tax at 32 %. In return for this low income tax level the employee has no tax deductions at all and can only be subject to these special rules for a period of up to 60 months (5 years).*

*In this context, the term "scientist" is relatively broadly defined and also includes other professions, e.g. professional footballers.*

*However, there are numerous requirements that have to be met for the person to be subject to these rules. One of the requirements is that the employee's fixed gross salary must exceed DKK 63.700 (approx. EUR 8.570) per month.*

### ► Taxes on personal dividends and/or capital gains

*For shares owned by persons who are tax liable in Denmark, dividends and/or capital gains will be taxed with 27 % of an amount up to DKK 51.700 and with 42 % of amounts exceeding DKK 51.700.*

# Denmark | FOREIGN INVESTMENT

In Denmark one can choose between a range of different legal entities for one's business. These vary from small entities with no share capital to companies with a minimum share capital of DKK 500.000. The most common entity types are the ApS (Private Limited Company) and A/S (Public Limited Company) entities. However many small businesses with only one owner operate as personal one-man businesses.

The two tables below illustrate the most common entity types, and list the most relevant characteristics of each type. Table 1 describes types of limited liability entities and Table 2 describes other types of entity forms, including a limited partnership. Each type of entity is further described below the tables.

## THE DANISH CURRENCY – THE “KRONER”

Denmark is a member of the European Exchange Rate Mechanism II. This means that the Danish currency, the krone, is locked to the Euro at a central rate of DKK 7,46038 to the Euro (1 DKK = 0,13404 Euro), with a fluctuation band of +/- 2.25 %. The current exchange rate (as of August 2017) is 1 Euro = 7.44 DKK.

## SETTING UP A BUSINESS

It is relatively easy to set up a business in Denmark. With professional assistance, a standard company takes only a few hours to register with the Danish Business Authority and the tax authorities before it is up and running. Setting up a Danish bank account, however, may take a little longer, depending on the bank in question, due to the banks' anti-money-laundering procedures.

## REGISTRATION OF INVESTMENT

As a main rule there are no requirements for foreign investors to register or obtain the authorities' permission for making investments, and there are no restrictions on the foreign ownership of Danish shares or bonds.

Danish companies must submit a registration to the Danish Business Authority and to the tax authorities before the start of operations. Furthermore, the management must be registered with the Danish Business Authority (please see the chapter about Corporate law for further information).

With regard to investments in Danish real estate, there are some restrictions on what types of properties foreigners are allowed to buy (please see the chapter regarding Real Estate for further information).

**FOREIGN EMPLOYEES**

Nationals of other countries within the EU or European Economic Area (EEA) are allowed to work and live in Denmark without obtaining a work permit or other permits. (A previous restriction on the free movement of workers from countries that joined the EU within the last 7 years ended on 31 December 2013, meaning nationals from all EU member states are now allowed to work and live in Denmark.) Employers are required to pay ATP Livslang Pension (Lifelong Pension) contributions on behalf of wage earners who are EEA nationals. The same rules apply to employees who are non-EEA nationals with two exceptions: 1) if the wage earner is employed in Denmark for a maximum of six months, or 2) if the wage earner is employed in Denmark for educational purposes and their stay does not exceed 18 months. Special rules apply to employees on Danish vessels. If Denmark and another country have entered a social security agreement, those rules will apply to employees from the respective country.

Nationals of countries outside the EU or EEA will need a visa and/or a work permit to enter and work in Denmark. The type of visa or work permit required depend on, among other criteria, the applicant's country of residence, educational background and the type of work to be performed in Denmark.

# Denmark | LABOUR LAW

There are three different categories of employees in Denmark, namely salaried employees (“white-collar”), non-salaried workers (“blue-collar”) and executive officers. It is important to determine the status of the employee in order to know the applicable legal framework.

All employees (except for executive officers) are subject to a number of statutory rules that determine the standards of protection of the employees. Further, collective bargaining agreements play an important role when determining the rights and obligations of the employer and employees.

Below is a brief overview of some of the main statutory acts and obligations which employers must know when employing persons in Denmark.

## **COLLECTIVE BARGAINING AGREEMENTS**

More than 2/3 of Danish employees are members of a trade union, and many collective bargaining agreements are in force within the Danish labour market. The collective bargaining agreements typically apply to specific areas of work, e.g. office work, the type of industry, etc. The collective bargaining agreements contain terms such as wages, working hours, notice periods, pension, overtime payment, etc. A collective bargaining agreement will only apply if the employer has entered into an agreement with the relevant employers association or trade union. It is voluntary for the employer to enter into a collective bargaining agreement, but in practice it may prove difficult to refuse if a trade union presents such a request, as the employer will then probably face industrial action initiated by the trade union.

## **THE EMPLOYERS' AND SALARIED EMPLOYEES ACT**

The Employers' and Salaried Employees Act will normally apply to employees who work within business and office areas for more than 8 hours per week. The act contains a range of mandatory rules for the protection of the salaried employees.

The employment of salaried employees may at the same time also be governed by a collective bargaining agreement.



## **EXECUTIVE OFFICERS**

The Employers' and Salaried Employees Act does not typically apply to executive officers of a company, unless otherwise agreed in the employment contract, collective bargaining agreements, or other acts protecting the employees. The reason for this is that an executive director is considered an employer and not an employee per se. As a consequence, the employment contract between a company and its executive officers typically contains detailed provisions on the rights and obligations of the executive officer.

## **THE EMPLOYERS' OBLIGATION TO INFORM OF THE EMPLOYMENT TERMS**

According to the Act on the Employers' Obligation to inform the Employee of the Employment Terms, the employer is legally obliged to inform its employees of all essential employment terms.

Such information must be provided in writing, typically in the employment contract or as an amendment to the contract. The statute specifies a number of terms that the employee must be notified of. The list of terms is not exhaustive, so the employer must consider the character of all terms of employment and subsequent changes therein when determining whether a written notification is required.

If the employer does not comply with the obligation to inform the employee of the essential employment terms, the employer may become liable to pay a compensation of up to 20 weeks salary.

## **NON-COMPETITION AND NON-SOLICITATION CLAUSES**

Since January 1 2016, more employee friendly rules apply to non-compete and non-solicitation clauses apply.. A non-compete clause may only be imposed on an employee holding a trusted position and it is required that the agreement contains a specific explanation as to why the non-compete clause is needed. The employee must be compensated in consideration of being subject to a non-compete or non-solicitation clause. The term of the restrictive clause can be no more than 12 months, commencing from the termination of the employment, or 6 months if it is a combined non-compete/non-solicitation clause. As opposed to the former rules, the above now applies to all kinds of wage earners.

## **WAGES AND WORKING HOURS**

Danish law does not specify any minimum wage. However, minimum wages are often prescribed in collective bargaining agreements. The Danish wage levels are typically rather high compared to other jurisdictions, including the wage levels of other member states of the European Union.

The most common number of working hours in the employment contract and collective bargaining agreements is 37 or 37½ hours per week including small breaks but excluding lunch breaks. As there are no statutory rules in Denmark for working hours, the working hours and terms for overtime are to be agreed upon in the employment contract or in a collective bargaining agreement. However, the average working week in Denmark should not exceed 48 hours.

## HOLIDAY

The Danish Holiday Act applies to all employees in Denmark except executive officers. Under the Holiday Act, employees are entitled to 25 days holiday each year, in addition to public holidays. Whether the holiday is paid by the employer or not depends on whether the employee has been employed during the preceding year. The Danish holiday system is rather complex with several mandatory rules for the protection of the employees. The employer may be liable for payment of a fine if the rules are not complied with.

## MATERNITY, PATERNITY AND PARENTAL LEAVE

### Employees who become parents have the following rights:

- Women are entitled to absence from work from 4 weeks before the expected birth with a statutory right of payment of 50 % of the salary during this period.
- Women are entitled to 14 weeks maternity leave after the child is born with a statutory right of payment of 50 % of the salary during this period.
- Men are entitled to take a total of 2 weeks of paternity leave at the same time as the mother's 14 weeks of maternity leave with no statutory right of payment of a salary.
- After the first 14 weeks, each parent is entitled to parental leave for 32 weeks which may be prolonged by up to 14 weeks.
- The parents are jointly entitled to up to 64 weeks of parental leave, but are only entitled to 32 weeks of maternity pay.

The rules on leave in connection with childbirth are very flexible for the parents, whom to a wide extent determine how they wish to divide the parental leave between them.

Employment contracts or collective bargaining rules often give the parents further rights of absence and compensation than the statutory rules.

If an employer chooses to terminate the employment of a pregnant employee or an employee on a leave, the employer has the burden of proof that the pregnancy or birth had no influence on the decision. In practice this burden of proof can be very difficult to lift. In case of unjustified termination of the employment, the employer will be liable to pay the employee a compensation, which will amount to at least 6 to 9 months' salary.

**NON-DISCRIMINATION**

It is prohibited to discriminate, directly or indirectly, on the grounds of gender, race (and skin colour), sexual orientation, age, handicap, religion (and religious beliefs), political beliefs or national, social or ethnic origin.

Non-compliance with the law is punishable by a payment of a fine or by paying compensation to the employee (or job applicant).

**TERMINATION OF EMPLOYMENT**

The Danish rules on termination of the employment relationship are relatively lenient from an employer's perspective when compared to many other jurisdictions. The notice period will normally be determined by the Employers' and Salaried Employees Act, an applicable collective bargaining agreement or the individual employment agreement.

Depending on the duration of the employment, the notice period of salaried employees is 1-6 months. It is possible to agree on a longer notice period than what is prescribed in the Employers' and Salaried Employees Act.

If the employee has been employed for more than 12, 15 or 18 years he or she is entitled to an allowance of respectively 1, 2 or 3 months' salary.

After one year of employment a dismissal must be reasonably justified by the company's or the employee's circumstances. If a court determines that the dismissal is unjustified, the employer may be liable to pay compensation of up to 6 months' salary to the employee.

If the employer makes essential changes to the terms of employment, it may be considered a dismissal and the employer must comply with the applicable requirements for dismissals.

The salaried employee may resign with one month's notice regardless of the duration of employment. It is possible to agree on a longer notice period.

The notice periods contained in collective bargaining agreements vary, but are often shorter than those of the Employers' and Salaried Employees Act.

**COLLECTIVE REDUNDANCIES**

The Collective Act may be applicable when employees are made redundant, depending on the number of affected employees. This act requires that the employer is obligated to inform and consult the employees before contemplated redundancies become effective. The procedure varies depending on the number of affected.

Many collective bargaining agreements also contain rules on redundancies. If the employer is party to a collective bargaining agreement with rules on redundancies, such rules will prevail instead of the statutory rules.

### **COLLECTIVE REDUNDANCIES**

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### **TRANSFERS OF UNDERTAKINGS**

The Danish Transfer of Undertakings Act, which implements the EU Acquired Rights Directive, protects employees' rights in the event of a transfer of a business or part of a business.

In the event of a transfer of a business or undertaking, the general principle of Danish law is that the employment rights and obligations of the employees of the business or the part of the business being transferred, will automatically be transferred to the new owner of the business who will automatically assume those rights and obligations instead of the vendor.

As a result, the main rule is that the vendor will be released from employer obligations and any claims made by the employees that date back to the period before the transfer. These will have to be presented to the new owner.

If the new owner decides to make essential changes to the employees' employment terms, it may be considered as a dismissal and the new owner must comply with the applicable requirements for dismissals.

# Denmark | REAL STATE

## TYPES OF REAL ESTATE

In Denmark one can either own or rent real estate, regardless of whether it is for business or private purposes. However, there are exceptions in regard to holiday houses. The most relevant rules for foreign businesses are described in general in the following chapter.

## OWNERSHIP RESTRICTIONS

Foreign persons and companies, including such from the European Economic Area (EEA), are, as a main rule, only entitled to buy real estate in Denmark, if they have previously resided in Denmark for a minimum of five years.

However, companies legally registered in an EU and EEA country that are establishing a business in Denmark (e.g. a branch) and citizens of the EEA seeking employment or establishing a business in Denmark, can freely buy real estate irrespective of the residential period. This exemption for businesses or citizens of the EEA seeking employment or establishing a business in Denmark does not, though, apply to holiday houses, meaning the requirement of at least five years residency on Denmark applies for any purchase of a holiday house in Denmark.

A subsidiary company established and registered in Denmark by a foreign parent company can freely buy property under the same conditions that apply to (other) Danish companies. However, as well Danish as foreign companies are not allowed to own holiday houses without the approval of the Danish Nature Agency. Because of this, it is not possible for foreigners to buy e.g. holiday houses through a Danish company.

Foreign persons or companies, who do not fulfil the five year residency requirement, are only allowed to buy real estate in Denmark with the approval of the Ministry of Justice.

The residency requirement is not applicable to foreigners who inherit real estate in Denmark.

## USE RESTRICTIONS

### ► Residential property

As a general rule homes are only for residential use. However, the owner can obtain an approval for full or partial business use.

Furthermore, the majority of the residential property in Denmark is subject to a residence requirement. This means that if a residential property is not occupied by the owner, the owner is obliged to enter into a lease agreement with a tenant. If the property is left empty by the owner for more than 6 months, the municipality in question may force the owner to enter into a lease agreement with a tenant appointed by the municipality. The purpose of this rule is to maintain a certain population standard in each municipality and prevent housing shortages.

Residential property must be used year-round. However an approval for temporary use can be obtained if certain requirements are met.

#### ► **Holiday houses**

Holiday houses may not be used as year-round residences. However, senior citizens may, if certain conditions are met, obtain permission for year-round use.

#### ► **Commercial properties**

Commercial properties may not be used for residential purposes.

Contrary to residential properties, there is no requirement to use the property and it may be left empty by the owner.

#### ► **Farms**

Farms are subject to detailed regulation concerning residence. They are mixed properties, since the farmhouse shall be used for residence and the rest of the property is a commercial property. As a general rule, the owner or tenant is obliged to live at the farm as well as to use it for farming.

## DISTRICT PLANS

The Danish Planning Act ensures an appropriate development in all parts of Denmark by planning future infrastructure, the use of different districts, preservation of urban areas etc. The act sets the ground rules which public authorities must follow for district planning.

Denmark is divided in to four levels of districts.

- **National level**  
A national district plan includes the whole country and must be enacted by the government. In practice there is more than one national district plan to simplify the preparation and enacting process.
- **Regional level**  
Denmark is divided in to five regions, which each have their own regional district plan. A regional district plan must be enacted by the region.

- **Municipal level**  
Denmark is divided in to 98 municipalities, which each have their own municipal district plan. Municipal district plans must be enacted by the relevant municipality.
- **Local level**  
In addition to plans on the municipal level, each municipality can enact local district plans. On a very detailed level such district plans are used to determine how specific properties can be used.

Besides being divided in to four planning levels, Denmark is divided in three kinds of land-use zones. All real estate can be assigned to one of these zones, and each zone restricts real estate usage in a different way.

- **City zones**  
The city zones can be used for everything besides holiday houses, e.g. residential and business real estate.
- **Land zones**  
As a main rule land zones can only be used for farming, forest management and for garden centres.
- **Holiday house zones**  
As a main rule, year round use of real estate in holiday housing zones is not permitted.

#### ► Planning permissions

*Management of planning permissions is handled by the municipality. Permission must be granted before the construction can begin. In cases where no permission has been granted, the municipality may demand that the building is demolished.*

## MORTGAGE FINANCING

The Danish mortgage credit system is unique in several aspects. The loan limits for home loans financed through issuing Danish mortgage bonds are set at 80% of the market value and it is possible to issue Danish mortgage bonds with maturities of up to 30 years, which greatly reduces the annual user cost of housing ownership. A loan-to-value ratio of 80% and maturity of up to 30 years are the usual terms for residential properties, while the loan-to-value limit for commercial properties is 60% and 40% for clean sites with no properties.

Additionally, the introduction of more flexible mortgage-loan options has been instrumental in reducing the cost of housing ownership. These loan options include interest-only mortgage financing, mortgage financing with floating interest rates and mortgage financing with capped interest rates. The floating interest rate mortgage loans are based on non-convertible mortgage bonds, where the interest rates are adjusted to market interest rates at pre-defined intervals.

## REGISTRATION IN THE DANISH LAND REGISTER

In Denmark, real property (land) is typically purchased pursuant to a purchase agreement, followed by a deed of transfer, which is entered into the Danish land register. This land register shows the identity of the owner, all registered mortgages and other rights and obligations such as purchase options, owner's bankruptcy etc.

In most cases, all other burdens and easements such as right of way, local restrictions on construction etc. will also appear in the register.

The land register system also serves as an easy and dependable way of providing security to lenders, as the ranking of priority of lenders will appear clearly on the property's list of mortgagees. As is the case for transfer documents, the registration of the mortgage will protect the mortgagee's rights to the property against subsequent purchasers and against the mortgagor's other creditors.

The land register in Denmark has recently been fully digitalized and centralized. This means that all information contained in the centralized land register is available online at no cost, and that all new registrations of deeds, mortgages, burdens etc. as well as the relevant parties' signing of the relevant documents are made digitally online.

## COMMERCIAL LEASES

Commercial leases are subject to the Danish Business Lease Act, which allows for a high degree of contractual freedom.

Almost all terms and conditions of commercial leasehold are subject to the parties' negotiations, including terms and conditions regarding rent, adjustment of rent, maintenance obligations, right of assignment, subletting, etc. However, with respect to the landlord's termination and payment of damages/compensation, the Danish Business Lease Act gives the tenants a high degree of protection.

### ► Duration

*Under the Danish lease law, there are only few restrictions in regards to the duration of a leasing contract. The majority of all commercial leases in Denmark run for an indefinite period of time.*

### ► Fixed-term lease contracts

*Fixed-term leasing contracts are not common in Denmark. A fixed-term leasing contract may not be terminated under the term, unless otherwise agreed to. However, a fixed-term lease is not valid under Danish law unless the fixed-term is well-reasoned in the landlord's needs. Consequently, a fixed-term may be overruled by the courts if the time-limitation is not found to be well-reasoned in the landlord's needs at the time when the lease contract was entered into.*

### ► Rent

*The parties are entitled to agree how the rent is to be determined and paid. Typically, rent is paid in advance on a monthly or a quarterly basis. It is also commonly agreed that the annual rent shall be adjusted every year, e.g. in accordance with changes in the official Danish 'Consumer Price Index' or a certain percentage thereof, or that the annual rent shall be increased by a fixed percentage.*



► **Adjustment to the market rent**

*According to the Business Leases Act, the rent may be adjusted on the basis of the 'market rent'. Such adjustments cannot take place until four years after commencement of the leasing agreement. These adjustment provisions in the act can be set aside by an express individual agreement in respect to both parties' access to claim such rent adjustments. It may also be agreed that only the landlord (or the tenant) is entitled to claim adjustment to market rent.*

► **Taxes and fees**

*The landlord pays all taxes and fees pertaining to the property. Unless otherwise agreed, such taxes and fees are included in the rent to the effect that either party may claim adjustment of rent if the taxes and fees are changed.*

► **Operating costs**

*Normally, the tenant, in addition to rent on account, pays for the supply and use of heating and hot water based on consumption. Usually, the tenant also pays all expenses for supply of electricity/power to the leased premises and is registered with the relevant utility companies as an independent user.*

*It is typically agreed that the tenant shall pay the leased premises' proportional (based on area) share of taxes and fees pertaining to the entire real property and other operating costs such as expenses for janitors, snow clearing, various building maintenance etc.*

► **Sublease and assignment**

*The tenant is not entitled to sublease the leased premises without the prior consent of the landlord. However, the lease agreement often contains provisions regarding the tenant's right to sublease. It follows from the Business Lease Act that the tenant is entitled to allow another tenant carrying out the same type of business as stated in the lease agreement to take over the lease contract on equal conditions, a so-called 'assignment' (as opposed to subleasing). According to the Act, the landlord is entitled to reject such assignment, if he has substantial and reasoned grounds for doing so, such as the incoming tenant's financial position or lack of business experience. The parties can agree that the provision in the Business Lease Act regarding assignment shall not apply. In such case, the tenant cannot assign the lease contract without the prior discretionary consent of the landlord. Further, the parties can agree on other assignment conditions as stipulated in the Act.*

► **Use and construction**

*Unless otherwise agreed in the lease agreement, the landlord is responsible for ensuring the legality of the agreed use of the property and the construction and furnishing of the premises, e.g. asbestos in the walls. However, it is often agreed that the tenant, apart from being responsible for the legality of his actual use and furnishing of the premises, also is responsible for any order issued from public authorities after the date of commencement.*

### ► Alterations

*As a general rule, unless otherwise agreed the tenant is not entitled to make alterations of the premises during the lease period apart from certain usual changes without the landlord's consent. Further, unless otherwise agreed in the lease agreement, the landlord is only entitled to claim re-establishment upon vacating the premises for alterations carried out during the lease period and approved by the landlord if the landlord at the time of approval has specifically reserved the right to claim reestablishment.*

### ► Tenant's termination

*The tenants may terminate a lease without stating any particular reason. However, it is quite normal that the parties agree that the lease cannot be terminated within a certain period of time. If this is the case, the tenant cannot terminate the lease during this period.*

### ► Landlord's termination

*It is also quite normal that the landlord must comply to a non-termination period. Furthermore, irrespective of an agreed non-terminability period, the landlord is only entitled to terminate the lease if the termination is based on specific reasons specified in the Business Leases Act, of which the relevant are:*

- If landlord wishes to use the leased premises himself, and the termination is deemed reasonable based on an evaluation of the situation of both parties.
- If the leased premises must be vacated due to a demolition of or an alteration of the building. However, if the premises in question are to be leased again after the rebuilding or alteration, the landlord is obliged to offer the tenant to lease premises of the same nature as those terminated in connection with the termination
- If other strong reasons make it particularly important for the landlord to terminate the lease.

*The previously mentioned access to adjust the rent to the 'market rent' every four years is, from the legislator, meant as a 'counterweight' to these restriction in the landlord's access to terminate the lease.*

### ► Damages and compensation to the tenant due to the landlord's termination

*According to the Business Lease Act, a tenant may claim damages incurred as a result of the landlord's termination. In addition, tenants who are business protected may claim compensation for loss of goodwill.*

## THE DANISH ENVIRONMENTAL LAW

### ► **Soil contamination**

*Under the Soil Contamination Act the Regional authorities are under an obligation to register/map all (potentially) contaminated areas in Denmark, with the exception of lightly contaminated sites. Registration can be made on level 1, if an area is likely to be contaminated due to the historic use, or on level 2, if it is known that an area is contaminated.*

*A registration in itself does not imply a liability or an obligation to remediate. Instead, a registration implies a number of restrictions relating to the use of the area in question. A registration does not in any way restrict the current use of the registered area, but a change of the current use, to a use considered 'sensitive' (a 'sensitive' use would be a use that potentially exposes people or the surrounding environment to contamination) requires a special permit from the authorities. Similarly, commencement of building and construction sites on a registered area that situated within an area with special drinking water reserves requires a special permit. Such permits may be conditioned upon the prior exercise of contamination investigation and/or remediation. The costs incurred in this respect must be paid by the owner/builder.*

### ► **Environmental liability**

*The Soil Contamination Act /The Environmental Protection Act authorises the environmental authorities to issue administrative orders requiring investigative or remedial actions to be taken in relation to soil and ground water contamination. Such requirements may be issued to the polluter. Basically, a polluter is any party who, for commercial or public purposes, operates or operated the company or uses or used the plant from which the contamination originated. This requires that the contamination must have been released entirely or in part during the period of operation in question. Where a contamination can be attributed to more than one polluter, administrative orders may be issued to all of them.*



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France

Pech de Laclause, Bathmanabane & Partners

# Pech de Laclause, Bathmanabane & Partners

—  
France

📍 8, place Vendôme  
75001 PARIS  
France

☎ +33 (0)1 44 94 98 98

☎ +33 (0)1 44 94 98 99

[www.pechdelaclause.com](http://www.pechdelaclause.com)

## **Nicolas Blanchenay**

*Mergers and acquisitions - M&A - Corporate  
- Finance*  
[nblanchenay@pechdelaclause.com](mailto:nblanchenay@pechdelaclause.com)

## **Philippe Pech de Laclause**

*Criminal Law – Civil and Commercial Litigation - Compliance*  
[philippe@pechdelaclause.com](mailto:philippe@pechdelaclause.com)

## **Pascal Bathmanabane**

*Labor and Employment Law*  
[pbathmanabane@pechdelaclause.com](mailto:pbathmanabane@pechdelaclause.com)

## **Catherine Popineau-Dehaillon**

*Civil litigation and Insurance*  
[cpopineau@pechdelaclause.com](mailto:cpopineau@pechdelaclause.com)

## **Emmanuel Gouesse**

*Criminal Law – Litigation - Compliance*  
[egouesse@pechdelaclause.com](mailto:egouesse@pechdelaclause.com)

## **Jean-François Treton**

*Labor and Employment Law*  
[jftreton@pechdelaclause.com](mailto:jftreton@pechdelaclause.com)

## **Michèle Anahory**

*Life Science and Pharmaceutical*  
[manahory@pechdelaclause.com](mailto:manahory@pechdelaclause.com)

## **Arnaud Pericard**

*Commercial Litigation - Regulated Professions*  
[apericard@pechdelaclause.com](mailto:apericard@pechdelaclause.com)

## **General Information**

Pech de Laclause, Bathmanabane & Partners is a Paris-based business law firm composed of a team of attorneys trained at major international law firms, law departments in significant multinational groups.

Our philosophy is to bring quality legal services by expert business-friendly attorneys with a focus on synergy, team cooperation and cost efficiency.

## **Main Areas of Practice**

Practice areas in which we provide dedicated and focused legal services:

Mergers and acquisitions  
Corporate Law  
General Commercial and Civil Litigation  
Insurance  
General Commercial Law  
Environment  
Privacy and personal data protection  
Real Estate - Construction  
Criminal Law (white collar crimes)  
Intellectual Property  
Torts and Personal Injury  
Health Care and Cosmetics  
Labor & Employment Law  
Life sciences

We are currently twenty-plus attorneys, including eight partners, fluent in English, Spanish, German and Italian.

## ► Legislative trends in French corporations law

*Generally speaking, corporate law in France has become more consumer- and citizen- oriented while still trying to improve the country's attractiveness to businesses. For the past two years, French corporate law is therefore governed by two main trends: modernization and simplification on the one hand, and fight against corruption and fraud on the other hand. Two fundamental statutes have been passed in this respect:*

### 1. Ordinance n°2016-131 dated February 11, 2016 reforming French Contract law

The purpose of this Ordinance is to modernize French contract law by reaffirming and clarifying some key principles among which: the good faith principle, the obligation to provide pre-contractual information, a statutory hardship theory (théorie de l'imprévision), the exemption for non-performance theory, contractual effects and enforceability vis-à-vis third parties, etc.

### 2. Law n°2016-1691 dated December 9, 2016

Loi Sapin 2 aims at rendering corporation law more business-friendly. For example, specific provisions simplify (a) the set of rules governing the change of corporate form and mergers or (b) the operation of sole-partnership companies.

It also enforces measures relating to transparency and to fight against fraud and corruption such as the filing of the identity of companies' beneficial owners with a public register or the approval of corporate executives and officers' compensation by the general shareholders meeting. In fact, as of April 1, 2018, all companies registered in France will have to disclose to the Commerce Register the identity of the ultimate beneficial owners of the capital.

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## ► Main corporate structures

*Traditionally, French corporate structures are divided between limited liability companies, where the liability of the shareholders are limited to their capital contributions, and unlimited liability companies.*



<b>Type of company</b>	<b>Nature</b>	<b>Legal Requirements</b>	<b>Tax status</b>
Sole proprietorship ( <i>Entreprise individuelle, Commerçant</i> )	Not a legal entity, but the registration of an individual undertaking a commercial activity	None except individual capacity to do business (majority, no prior bankruptcy-related prohibition)	Personal income tax
Limited liability company ( <i>Société à responsabilité limitée, or "SARL"</i> )	Limited liability entity governed by the French Commercial Code	No minimum share capital 100 shareholders maximum	Corporate income tax with option for personal income tax
Public limited company ( <i>Société anonyme, or "SA"</i> )	Limited liability entity governed by the French Commercial Code	Minimum share capital of €37,000 Minimum 2 shareholders Mandatory appointment of statutory auditor	Corporate income tax
Joint-stock company ( <i>Société par actions simplifiée, or "SAS"</i> )	Limited liability governed by the French Commercial Code	No minimum share capital Statutory auditor required under certain conditions relating to turnover, number of employees and balance sheet total	Corporate income tax
Commercial Partnerships ( <i>Société en nom collectif, or "SNC"</i> )	Unlimited and joint liability of the shareholders	No minimum share capital Minimum 2 shareholders Statutory auditor required under certain conditions relating to turnover, number of employees and balance sheet total	Personal income tax with option for corporate income tax

**Notes**

Unlimited liability vis-à-vis creditors and third parties  
Common among small businesses

Most common corporate form  
Very common for small and family businesses  
"Turnkey" type of company with well-developed case law  
Limited formalism except when the SARL meets certain criteria in terms of turnover and number of employees  
The Management Body of an SARL may comprise 1 or more Managers that must be individuals  
The Manager is vested with the broadest powers to represent the company

Suitable for big companies  
Able to market its capital on stock capital markets and raise funds from the general public  
Heavy formalism with (i) either a Board of Directors and an Executive Officer, or (ii) a Supervisory Board and a Management Board

Very common and flexible corporate form  
The by-laws set forth the conditions under which the company is governed and organized, with limited imperative rules  
The company is represented vis-à-vis third parties by a President who is vested with the broadest powers to act  
The President of a SAS may be a legal entity

The management SNC may be run by a legal entity or individuals  
Limited rules of governance, mostly left to the articles of organization

**► Rules governing all corporations and partnerships****1. Incorporation**

The incorporation process in France requires several mandatory steps, failing which the registration will not be recorded by the Commercial Court Registry (Greffé du Tribunal de Commerce) and the entity will not have any legal existence.

Those steps usually include the filing of the by-laws (statuts), documentation relating to the directors and officers, a certificate of deposit for the initial share capital, the justification of the right to use the designated headquarters or the identity of the statutory auditors (if applicable). Incorporation process also requires certain publicity in a legal gazette in the jurisdiction of incorporation.

All these are requisites for the registration with the Commercial and Companies Register ("RCS"), which is now freely accessible from publicly available databases (Infogreffe, Société.com).

Evidence of registration is given through an excerpt of the RCS for a given entity; such document is called a "K-bis".

Obviously, supplying false information to the RCS is a criminal offense.

**2. Corporate Disclosure and Filings**

Under French law, third parties rely on the information provided by the K-bis for any given entity, in particular in determining which officers are legally empowered to bind the company.

Any change affecting the information mentioned in the K-bis must be notified to the Commercial Court for an update. Any change that is not reflected in the K-bis is deemed not to be binding to third parties. Some changes such as a change of the location of headquarters must absolutely be notified to the RCS since notifications sent to the address indicated in the K-bis will be deemed valid, even if the company has effectively moved to another location.

In addition, all commercial entities must file their annual financial statements with the RCS so that third parties may be aware of the financial situation of a company.

Since 2016, small business have the option of requesting the confidentiality of their profit and loss statement (small businesses) and/or their balance sheet (micro businesses).

Mergers, spin-offs, and other specific operations affecting the assets or liabilities of an entity, such as the transfer of a business as a going concern (cession de fonds de commerce) require the filing of draft documents before the decision is submitted to the shareholders, and are subject to a waiting period in order for any interest party to be informed of any potential risk relating to his interests and to have a legal opportunity to obtain guarantees.

### 3. Directors and Officers

Directors and officers can be revoked at any time, subject to minimum process. However, revoking general managers in SARLs and SNCs, and members of the directorate in SAs without due cause may result in a legal action for damages.

Foreign individuals who are not citizens of the EU or of the EEE and who are not residents in France must make a specific filing with the local authorities. Those who wish to reside in France may be required to apply for a resident visa.

Directors and officers of a company are personally liable vis-à-vis the company or its shareholders for any negligence in the management; individual directors may not be held liable if they opposed the reprehensible action during a vote of the board. Directors and officers are liable vis-à-vis third parties if they act in a manner which is not compatible with their duties, but also for willful misconduct, breach of any applicable law or regulation, or a breach of the by-laws of the company.

Directors and officers of all companies are criminally liable for breaches of safety and labor laws and regulations (such as negligence in a work accident) unless they have duly transferred their responsibility under delegations of authorities for the delegates to comply with the relevant regulations.

Directors and officers that have been negligent in the management of the company's affairs and that subsequently filed for bankruptcy may be held liable for part or all of the company's liabilities.

### 3. Corporate assets

French law severely punishes the divestment by directors and officers of the company's assets for personal gain and/or for a use that is contrary to the entity's interest insofar as such behavior is considered as a breach of duty to the entity involved. Such divestments, called "abus de biens sociaux" or "abus de confiance" include, for example, unjustified discounted sales, transfers of the company's assets to directors or shareholders without corporate approval, personal use of the company's assets, inappropriate compensation, corporate guarantee given to comfort the director's personal loans or liabilities, etc.

## INCOME TAXES

France has four categories of income tax: corporation income tax, individual income tax, social contributions and payroll taxes.

This section mainly focuses on corporation tax.

### ► Corporation Income Tax (CIT)

*CIT is an annual tax on the total profits made in France (not worldwide revenues) by companies and other corporate entities.*

*Certain entities are liable to CIT due to their corporate status (i.e. notably the société anonyme, the société par actions simplifiée and the société à responsabilité limitée depending on their shareholding). CIT also applies to other corporate entities according to the nature of their business. Civil companies for instance (société civile), which are non-commercial companies by status, and even not for profit organizations, which carry out notably an industrial or a commercial activity are liable to pay CIT.*

*Partnerships, whose profits and losses are included in the income of the partners in proportion of their shares in the profits, may in certain cases elect to be liable to CIT.*

*Corporate bodies may be subject to CIT at the standard rate for all their activities, or for some of the corporate bodies at reduced rates.*

**The standard rate of CIT is 33.33%** but specific rates are applicable depending on the size of business, from a 15% rate for small businesses to 37.7% for large businesses which turnover or annual CIT exceeds specific thresholds.

However, the standard rate of CIT is expected to be lowered to 28% in 2020 due to recent proposed legislation. (CIT is not deductible).

**Tax losses may be carried forward with no time limit**, subject however to the absence of change of the core activity of the company.

**Interest incurred by a company for the purchase of the shares of a subsidiary are fully deductible** from the CIT basis, subject however to specific rules in relation with thin capitalization and deductible rate limitations applicable within groups of companies.

**A French participation exemption regime** is available when a holding company has held at least 10% of the share capital of the subsidiary which shares are transferred for a minimum period of two years. The capital gain realized is taxable at an effective CIT rate of 4%.

**Dividend distributions are taxable at an effective CIT rate of 1.67%** provided the shares of the distributing entity are held or will be held for more than two years, and the receiving company holds at least 5% of the share capital of the distributing entity.

**Tax grouping ("integration fiscale")** is available when 95% or more of the share capital of the subsidiaries is held directly or indirectly by the head of the tax group. The tax grouping election notably allows the matching of profits and losses derived by the companies which are members

of the same tax group, and allows avoiding CIT taxation, notably for intra-group distributions and subsidies.

**CIT neutral regimes are available for corporate reorganizations** such as mergers, business or shares contributions, spin-offs and most cross-border EU reorganizations. Pre-operations tax rulings can be sought for non-EU cross-border reorganizations.

As far as **CIT incentives** are concerned, France is well known for some attractive CIT credits such as:

- CIT credit for research expenses (where up to 40% of the eligible research costs incurred entitle the company to a CIT credit, which can even be refunded after a certain period).
- CIT credit applicable in the gaming, movie and music industries.

### ► Individual income taxation

For French tax residents, personal income tax is levied on the total worldwide income (subject to tax treaty provisions). The tax is computed on a civil year period.

The personal income tax is a scheduler tax. The main schedules are: business profits (i.e. business activity directly performed by individuals), non-commercial activities (i.e. deemed intellectual civil activities derived by doctors and lawyers for instance, together with income which does not fall within the scope of another schedule), agricultural income, real property income, salaries and pensions, fixed and non-fixed income from financial instruments (mostly dividends and interest) and capital gains. Each schedule has its own income determination and computation rules.

For a single person, the tax brackets and rates for 2017 are the followings:

Amount of income (€)	Tax rates (%)
below 9,710	0
between 9,710 and 26,818	14
between 26,818 and 71,898	30
Between 71,898 and 152,260	41
Above 152,260	45

Specific expatriates and "impatriates" (i.e. individuals transferring their tax residence to France) regimes offer notably attractive income tax exemption regimes.

### ► Social Contributions

In most cases, non-French tax residents are not liable for social contributions.

When applicable (to residents or non-residents), their rate vary from 8% to 15.5%, depending on the nature of the income derived (business income or capital income).

## VALUE ADDED TAX (VAT)

As an active UE Member State, France has almost fully implemented the VAT Directive.

The current ordinary VAT rate is set at 20%.

Reduced rates of 5.5% and 10% are applicable to specific services and products. Some areas in France (Corsica and overseas territories) benefit from lower VAT rates due to their specific isolated situation.

There are several exemptions available, concerning in particular:

- Certain financial transactions (granting and negotiating credits and shares, credit management by lenders, negotiating and taking charge of commitments, guarantees and other securities as well as credit management by credit grantors, etc.)
- Certain real estate leasing activities
- Insurance and reinsurance as well as service supplies pertaining thereto
- Medical and paramedical activities and hospital care costs
- Charities
- Education

An election for VAT taxation of exempt activities is available for some exempt activities such as bare buildings lessors, rural property lessors and certain banking and financial transactions.

## REGISTRATION TAXES

The purchaser is liable for registration taxes when acquiring certain assets. The taxes are based on the sale price (or fair market value if higher, as appraised by the tax authority). No cap is applicable.

### ► Shares

*Registration duties applicable for the transfer of corporation shares such as the “actions” of non-real estate companies (shares of corporations such as SA, SAS, SCA) are computed at the rate of 0.1%. This registration duty does not apply to the sale of shares on listed securities markets.*

*Registration duties applicable for the transfer of equity interests (“parts sociales”) of close corporations and companies (SARLs, SNCs, civil companies) non-real estate companies are computed at the maximum rate of 3%.*

*Registration duties applicable for the transfer of shares of “(predominantly) real estate companies” (i.e. which balance sheet is made up at more than 50% of real estate assets) are computed at the rate of 5%.*

*The transfer of shares between companies which are members of the same tax group, or which are deemed to be controlled by the same entity, is exempt from registration tax.*

### ► Direct assets deals

*Registration duties applicable for the transfer of an ongoing business (“fonds de commerce”) are computed at progressive rates based on the purchase price (or fair market value). The highest tax rate applicable for a transfer value above 200,000 € is 5%.*

*Registration duties applicable for the transfer of real estate assets are computed at progressive rates with certain local exemptions. However, in most cases, a global rate of 7%, including notary fees, is applicable.*

*Transfers of patents are liable to a limited flat registration tax.*

*Transfers of trademarks exploited in France are liable to the same regime as for the transfer of an ongoing business. A limited flat registration tax is eventually applicable in other cases.*

## WEALTH TAX (“IMPÔT DE SOLIDARITÉ SUR LA FORTUNE” OR “ISF”)

[subject to modification resulting from the Budget Act for 2018]

French tax residents whose net taxable worldwide assets (i.e. minus debt and other liabilities) are worth at least 1.3 M€ are liable for the wealth tax.

Non-French tax residents are liable to the wealth tax only upon their French based assets which value is at least 1.3 M€; as of 2018, French based financial assets will be largely exempt.

Net Assets (€)	Tax rate (%)
below 800,000	0
between 800,000 and 1,3 M	(for the part exceeding 800,000 €) 0,5
between 1,3M and 2,57 M	0,7
between 2,57 and 5 M	1
Between 5M and 10M	1,25
Above 10M	1,5

## LOCAL TAXES

### ► Added value

*Businesses are liable to a local tax based on the added value generated computed at the rate of 1.5%. Multiple specific exemptions are available for small and mid-size businesses.*

### ► Real estate

*Real estate property which is:*

- Owned - whether by companies or individuals - as of January 1, trigger an annual ownership tax ("taxe foncière") based on a specific rental value of the asset
- Owned, leased or used by a company or a business trigger an annual business tax ("contribution foncière des entreprises") based on a specific rental value of the asset
- Used by individuals as their inhabitation as of January 1, trigger an annual residency tax ("taxe d'habitation") based on the specific rental value of the asset

## INTERNATIONAL TAXATION

The French withholding tax (WHT) on most interest paid to non-residents is no longer in effect, except for payments made within tax heavens related schemes.

The WHT on dividends is computed at rates which vary between 15% (dividends paid to non-profit organizations) and 30%, except payments made to tax heavens or related schemes. Most distributions to EU-based companies are exempt of WHT.

The above mentioned domestic rates are subject to tax treaty provisions, which are likely to reduce the WHT liability or simply waive it.

France is among the very few OECD countries to have entered into over 100 tax treaties with other countries, therefore offering tax efficiency for cross-border transactions.

# France | FOREIGN INVESTMENT

Foreign investment in France is by principle free of any administrative constraint.

However, in certain instances, foreign investment in France is subject to either declaration of prior notice:

## OPERATIONS SUBJECT TO DECLARATION

**1. The following operations are subject to declaration to the administration when made by foreign investors or by French entities whose capital or voting rights are held at more than 33.33% by foreigners:**

- a. Incorporation of a business
- b. Acquisition of all or part of an ongoing business
- c. Any equity investment resulting in a stake exceeding 33.33% of the capital or the voting rights of a French entity
- d. Any operation organized abroad resulting in a change of control of a foreign entity, itself holding capital or voting rights in an entity whose capital or voting rights are held by foreigners at more than 33.33%

**2. The declaration must be made with the "Direction Générale du Trésor" of the French Ministry of the Economy, of Finances and of the Industry. There is no required format**

**3. A general waiver is granted for the following operations:**

- a. Creation or extension of the business of an existing French entity, increase in the stake in French entity under foreign control when made by an investor already owning over 50% of the capital or the voting rights
- b. subscription to a capital increase of a French entity under foreign control, subject to the absence of increase of his/her stake
- c. Intra-group operations
- d. Operations relating to guarantees or donations to a French entity already owned by foreign investors
- e. The takeover up to 1.5 million Euros of businesses as a going concern ("fond de commerce"), restaurants, hotels
- f. Acquisition of arable land

## OPERATION SUBJECT TO PRIOR AUTHORIZATION FROM THE FRENCH ADMINISTRATION

A prior application must be made to the Minister of the Economy; the Minister has up to 2 months to respond, failing which the operation is deemed authorized.

**1. Investment made by non-European Union (or EEE) investors including:**

- a. Individuals citizen of countries that do not belong to the EU
- b. French citizens not residing in France



c. Investment in certain industries considered to be sensitive (off-casino gambling, private security business, communication interceptions, encryption, national defense certified contractors, R&D businesses, manufacturing or trading weapons, ammunition, powder or explosives, military contractors...). A 2014 statute added to the list the following sectors when the public order is concerned: energy supply, water supply, transportation, IT-industry and public health

**2. Investment by EU (or EEE) investors**

Investment in regulated sectors mentioned at article R.153-4 of the French Monetary and Financial Code, such as research, production and trading of weapons, business conducted by companies that receive national defense secrets, or other related national security organizations, or other business subject to security clearances (secret defense), in addition to the sectors added by the 2014 statute mentioned above.

**3. Investment by French entities** (subject to foreign control)

- a. Relating to encryption
- b. Holding or using national defense secrets
- c. Conducting R&D, or producing or trading in weapons, ammunition, powder and explosives, for military use
- d. That procure services or goods to the Ministry of Defense
- e. That deal in gambling, private security, biotechnology, and some activities tied to IT systems in addition to the sectors added by the 2014 statute mentioned above

## OPERATIONS SUBJECT TO FILING FOR STATISTICAL PURPOSES

**1. Operations involving amounts in excess of 15 million Euros require a filing with the Banque de France, when the operation relates to:**

- a. The acquisition of at least 10% of the capital or voting rights
- b. Acquisition of real estate
- c. Operation between related parties such as loans, deposits

**2. Operations involving amounts in excess of 1.5 million Euros require a filing with the French Ministry of the Economy, when the operation relates to:**

- a. Real estate acquisition
- b. Acquisition of land for wine production
- c. Liquidation of direct investments in France
- d. Operation subject to authorization by the Ministry of the Economy
- e. disinvestment in a French entity (termination of business, liquidation...)

# France | LABOUR & EMPLOYMENT LAW

## INTRODUCTION

French labor and employment rules, both individual and collective employment relationships between employers and their employees, are governed by the traditional hierarchy of rules, from:

1. The French Constitution, including the Declaration of the Rights of Man and the Citizen (a fundamental legal source from the time of the French Revolution)
2. European Union legislation and case law
3. The French Labor Code, together with the applicable regulations
4. Industry-wide collective bargaining agreement
5. case law

Individual relationships are also governed by the individual employment contract, customs, unilateral undertakings from employers and the internal rules and policies applicable within the companies.

The French Labor Code has recently been modified by six Ordinances (published in the official journal on September 23, 2017), in the extension of the Habilitation statute of August, 2 2017, in order to strengthen the “social dialogue”.

These Ordinances overhaul the French labor’s rules relating in particular with respect to:

1. Collective negotiations
2. Termination of the employment contract (collective economic dismissals, individual dismissals and more flexibility in the rules for dismissal)
3. Staff representatives’ bodies
4. The number of areas which are open to negotiation have been increased
5. Employee representative bodies have merged
6. small and medium businesses will be granted the possibility to enter into agreements directly with employees where no trade unions are present in the company
7. the establishment of a scale applicable to damages awarded by Employment courts for unfair dismissal

Some of these new measures are applicable starting from September 24, 2017. Others shall come into force after the publication of Decrees implementing them, on January 1, 2018, at the latest.

## EMPLOYMENT

### ► Employment contracts

*Under French law, the employer and the employee may enter into a fixed term contract (CDD), an open-ended term contract (CDI) or a temporary work contract ("interim").*

*A contract can be written, oral or result from an exchange of correspondence.*

*Fixed-term employment contracts and temporary work contracts must be written and have to comply with restrictive regulation, in particular with regard to their purpose and their duration. In case of breach of these rules, the employment relationship can be judicially converted in an open-ended employment contract.*

### ► Employment formalities

*The employer must file social security returns for new hires. Moreover, under French law, specific rules exist with regard to the employment of foreign employees, under which the employer must satisfy specific formalities before employing a foreign employee. Employing a foreign employee who has no authorization to work, or without checking the validity of the authorization of a foreign employee is a criminal offence.*

*Criminal sanctions in Employment law:*

#### 1. Discrimination

During the employment process, French law prohibits employment discrimination, in particular discrimination based on the origin, race, religion, age, sexual orientation, political opinions, or union status. Any breach of this rule may be criminally sanctioned and lead to damages

Unreported work ("travail dissimulé") is the offence constituted by:

- Paid employment (production, business, services, etc.) without being registered with the French authorities (employment, tax, or the social security organisms)
- Failure to (i) declare the hiring of an employee, (ii) provide a pay slip, (iii) mention on the pay slip the accurate number of hours worked or (iv) report the full salary (including benefits) paid to social security organizations

#### 2. Illegal loan of workers

Under French law, exclusive and for-profit loan of workers is reserved to the temporary work and work-share agencies

Employers are therefore forbidden to receive a financial gain from loaning their employees for the benefit of other employers, even to affiliates in a same group. A company may loan one or several workers to another company, as long as it generates no financial gain from this operation. There is no financial gain when the cost charged to the beneficiary of the loan is limited to the costs of the actual salaries, social security contributions and professional expenses

#### 3. Illegal trading of workers ("marchandage")

Illegal trading of workers is the loan of workers for profit which negatively affects the interests of the employee concerned or which distorts the application of legal rules, a labor convention or collective agreement

This offence is constituted when the employees loaned do not enjoy the same benefits as the employees of the company to which they are seconded

**4. Subcontracting**

Companies often employ subcontractors to execute part of the works entrusted to them by their clients. Those operations are legal, but particular attention is needed on two particular points:

- All contracts corresponding to an operation amounting to at least 5,000 Euros (excluded VAT and for the global amount of the services provided), the contractor must ensure, during the conclusion of the subcontracting agreement and every 6 months afterwards, that his subcontractor reports all his workers (see above), and specifically, that he is up to date with the mandatory declarations to the social security organisms and fiscal obligations. Failing to do so may result in the contractor being held jointly and severally liable for the social obligations and contributions of the subcontractor. If the subcontractor employs foreign employees, the contractor must moreover ask and be provided with declaration upon which the foreign employees are entitled to work in France
- Moreover, subcontracting may amount to a temporary loan of an employee of the subcontractor to the contractor's company. In this instance, the contractor should ensure that the loan of this employee is only an accessory to the services provided by the subcontractor and not the main goal (or benefit) of the subcontract. Otherwise, there is a risk that the services supplied by the subcontractor may be qualified as "illegal trading of workers" or "marchandage", a criminal offence

A company located in France using foreign labor must exert a control over its subcontractors pursuant to a July 11, 2014 Statute aimed at preventing "social dumping" and its implementing Decree dated March 30, 2015

**COMPENSATION****► Minimum wage**

*In France, employers are free to determine the compensation to be paid to its employee, provided it is above the "salaire minimum de croissance" (acronym "SMIC"), which is a minimum wage, increased by the French Government on the basis of the national cost of living index. The current rate for 2017 of the SMIC is 9.76 € / per hour, or a gross monthly salary of 1,480.27 €.*

*Each employee's compensation must also meet the minimum requirements of the collective bargaining agreement applicable to the company's industry, if applicable (which cannot fall below the SMIC).*

**► The "equal work, equal pay" principle**

*A consistent line of case law has determined that the employer must ensure the equality of compensation between all employees placed in identical situations. In a nutshell, the employer may only use his managing power ("pouvoir de direction") to treat employees differently provided he/she can justify such differences by criteria that are "unbiased, relevant, physically verifiable and not linked with any discriminatory motive".*

*Subject to certain conditions and context, the employer is entitled to justify differences of compensation based on the experience and seniority, professional skills or education.*

**► Social security contributions / Payroll taxes**

*They amount to 60-70 % of the employee's gross salary (40 to 50% paid by the employer, and 20 to 25% by the employee), depending on the industry and applicable collective bargaining agreements.*

## WORKING TIME DURATION

### ► General rules

*In France, the working time duration is by default set at 35 hours per week (i.e. 151,67 hours per month). Time worked above that limit constitutes overtime and is subject to an additional payment, and, in some cases, to rest days.*

*The law also provides for the following absolute working time duration limits:*

- a. A maximum of 10 hours a day
- b. An average of 44 hours in a 12 consecutive weeks period
- c. No more than 48 hours in a single work week

Each employee must in any case benefit from a daily 11-hour rest. Any employee, even classified as an executive ("cadre"), is submitted to these rules.

### ► Specific regimes for executives

*Nevertheless, the law provides specific rules for executives only which allow more flexibility. These regimes vary according to the executive's category and upon the applicable collective bargaining agreement provisions, if any.*

*Three categories may be distinguished:*

#### 1. Integrated executives

Those are subject to the company's collective working time and who are integrated in a working team.

They are subject to the mandatory provisions on working time.

#### 2. Senior executives

Executives who have significant responsibilities and are the decision-makers in the company; their work hours cannot be quantified due to a high degree of independence in the organization of their work; they are granted the highest compensations of the company.

The senior executives are excluded from the working hours legislative framework

#### 3. Autonomous executives

They are leading executives with significant freedom to organize their own work time.

Their working time may be defined by an amount of hours or a number of days per year if the collective bargaining agreement or a company bargaining agreement (negotiated at the level of the company with the unions, if any) provides for this option. To define the working time by a number of days also requires the express consent of the employee. To that purpose, an agreement must be signed with the employee (either in the employment contract itself or in a rider).

### ► Part-time contract

*A part-time work contract providing for fewer than 35 hours a week can be concluded with the employee. It must contain mandatory provisions to be valid. Since 1st of July 2014, the weekly working time cannot be fewer than 24 hours (limited exceptions apply. French part-time contracts have to comply with the legal provisions (mandatory mentions, priority of reemployment, equality of treatment...)).*

► **Paid vacation**

*Employees are entitled to five weeks of paid vacation per year. The collective bargaining agreement applicable to the company may provide for additional paid vacations.*

► **Specific rules**

*French law provides specific provisions concerning night work, bank holidays, and Sunday work.*

## TERMINATION OF EMPLOYMENT

► **Grounds of dismissal**

*The employer may only terminate an employment contract and dismiss an employee if justifies:*

- |  |   |
|--|---|
| <p>a. An "actual" cause: termination must be based on objective facts which can be substantiated, constituting the real cause of the dismissal, i.e. an accurate and exact cause</p> | <p>b. A "serious" cause: the grounds for termination must be of significance, making it impossible for the employer to continue the employment relationship</p> |
|--|---|

*The grounds for dismissal must be fully and exhaustively detailed in the letter notifying the dismissal to the employee. Nevertheless, according to the new Ordinance of September 22, 2017, regarding the securing of the work relations, starting from January 1, 2018 at the latest, the employer will have the possibility to complete the grounds for dismissal, either on its own initiative or at the request of the employee, after the notification has been given. If the employee does not ask for the grounds of his dismissal to be specified, insufficient justification of his dismissal letter will therefore only constitute an error which no longer systematically deprives the dismissal of its just cause, but gives rise to compensation of no more than one month's salary. On this regard, standard form letters (Cerfa) for dismissal mentioning the rights and obligations of employers and employees will be also implemented by decree.*

*There are three basic types of actual and serious reasons for dismissal:*

### 1. Dismissal for personal reasons

The reason for dismissal is directly related to the employee, for instance in case of lack of performance, or if the employee has had an accident or is ill and therefore unfit for work.

In such circumstances, the employee must be convened to a preliminary meeting during which the reasons for his potential dismissal are explained to him by the employer. After this meeting, the employer may decide to dismiss the employee and notify him the dismissal by a registered letter with return receipt requested.

This procedure is quite formal and the employer must comply with specific delays. In case of non-compliance with those delays, the employer may be ordered to pay compensatory damages to the employee for breach of the dismissal procedure (no more than one-month salary).

The physical inaptitude of the employee may constitute an actual and serious cause of dismissal, but only if such inaptitude has been noted by the occupational health doctor after a medical examination held in conformity with the new modalities of recognition of the physical inaptitude implemented by the statute of August 8, 2016 ("Loi Travail"), in force since January 1, 2017, after having consulted the staff representatives and if there are no possibilities redeploying of the

employee within the company or the group of the employer, unless the occupational health doctor provided for the impossibility of redeploying the employee.

On January 1, 2018, a Decree will provide for the geographical scope of the redeployment to be retrained, which will correspond to the Group companies located in France only.

## **2. Disciplinary dismissal**

The employee may be dismissed for negligence with respect to his/her contractual obligations (breach of internal procedures, unjustified absences...), for breach of her duty of loyalty towards the employer (unfair competition, denigration...), or when the employee's behavior towards his colleagues is inappropriate (insults, assault, workplace or moral or sexual harassment...).

However, a disciplinary procedure may solely be engaged within a period of two months starting from the day the underlying facts became known to the employer. Any previous wrongdoings are time-barred.

Finally, the dismissal letter has to be sent within a one month from the day the preliminary meeting took place. Failing this, the dismissal is deemed unjustified.

## **3. Dismissal for economic reasons**

Such cause for dismissal is based on reasons unrelated to the employee and relating to the necessity of modifying or reducing the headcount in order to face economic difficulties (such as the economic difficulties listed by the French Labor Code) or to safeguard the competitiveness of the company.

Economic grounds for dismissal are no longer evaluated at a worldwide level for companies belonging to a group (except in the event of fraud) and financial difficulties are now evaluated by the courts at the level of group companies located in France having the same activity.

Specific rules govern such a dismissal and vary when the dismissal applies to i) a single employee (individual dismissal), ii) from two to nine employees (small collective economic dismissal), and iii) ten or more employees (large collective economic dismissal).

In any case, an economic dismissal may only be brought if there is no possibility to redeploy the employee or alternative job opportunity within both the company and the group. On this issue, the redeploying measures have been simplified by the President Macron's reform of the French Labor Code: the employer will have the possibility to choose between individual and personalized offer of deployment, or a collective information of the jobs available on the intranet of the company, starting from the publication of its implementing Decree in January 1, 2018, at the latest. The employer will not have any more the obligation to propose available jobs abroad.

Moreover, in case of a small economic dismissal and a large economic dismissal, the Works Council ("comité d'entreprise") has to be consulted before the dismissal letters are sent to the employees. Such consultation will necessarily change following the merging of employee representative bodies into a Social and Economic Council (see below) which shall have to be implemented within the companies on January 1, 2020 at the latest.

In case of a large economic dismissal in a company of 50 or more employees, the Works Council (for now) may be assisted by a certified accountant who is paid by the company. A June 2013 statute sets a time limit during under which the Works Council must render its opinion.

This statute also provided for a specific procedure that has to be followed in case of such large collective dismissals. Indeed, specific rules have to be complied with, such as, for instance, in these cases, the obligation for the company to put in place an employment safeguard plan providing for internal and external redeployment measures and the support of the dismissed employees (assistance for geographical mobility, increase of the severance payments...).

Such a plan has to provide for sufficient support measures considering the capacities of the company and the group to which it belongs. If such a plan is considered insufficient, the notified dismissals are deemed void and the employees may petition the courts to request their reinstatement with the company, with compensatory damages and back pay.

Since the June 2013 Statute, the labor administration must approve the economic dismissal plan before its implementation.

### ► Severance payments

*In most cases, a dismissed employee is entitled to:*

- |  |  |
|--|--|
| <p>a. A notice period, in general 1 to 2 gross monthly salary for workers ("ouvriers"), 2 months for technicians and supervisors ("agents de maîtrise"), 3 months for the executives and engineers ("cadres et ingénieurs"), in conformity with the collective bargaining agreements, or, in case only law applies, a notice period depending on the employees' seniority within the company</p> | <p>b. A severance payment based on current compensation and seniority, provided by law or by the applicable collective bargaining agreement, whichever is more favorable to the employee</p> |
|--|--|

*The severance payment is paid to the employee who has at least 8 months of seniority. This payment amounts to 1/4 of a monthly gross salary per year of seniority up to 10 years of seniority, and then 1/3rd of a monthly gross salary from the 11th year of seniority.*

*If the dismissal is not justified, the employee may also obtain before the labor court additional damages, which amount depends on the damage actually incurred by the employee and according to a compensation scale with respect to unfair dismissals provided by the President Macron's Ordinances of September 2017 (which does not apply in cases of discrimination, harassment or violations of constitutional rights). Such a scale provides for a minimum amount of damages and a maximum amount, depending on the seniority of the employee and the number of employees within the company.*

### ► Amicable termination agreements

*The employer and the employee may reach an amicable settlement agreement which is not construed either as a dismissal or as a resignation, and may together decide to mutually terminate the employment contract. Such an amicable termination has to comply with a specific process and to be approved by the labour and employment departmental office (or the Labour Inspection in case it concerns a protected employee).*

*A "collective contractual termination" has also been created, consisting of a voluntary departure plan by collective agreement subject to approval by the administration. The modalities of application of this collective settlement agreement shall be fixed by Decree.*



## EMPLOYEES REPRESENTATIVES

### ► The Social and Economic Council

*By end of 2019, all companies of at least 11 employees, will have to set up a Social and Economic Council. Within companies of at least 50 employees, the staff delegates, the works council and the health and safety committee will merge into this new representative body. Within companies of more than 11 employees but less than 50 employees, this representative body will carry out the tasks of staff delegates (délégués du personnel). Such a council will have to be set up in all companies at the time of their next professional election process.*

*In the meanwhile, the companies have the possibility to extend the current mandates by one additional year in case the next professional elections are supposed to take place before the end of 2018.*

*Such a Social and Economic Council could also become a Company Committee (merging of all staff representative bodies and trade-union delegates into a Company Committee).*

### ► Union representatives

*Within companies of more than 50 employees, trade unions may appoint union representatives to represent them. They are not employees elected by the staff but appointed by representative union organizations within the company.*

*When the trade-union is deemed to be "representative", it may appoint one or more union representatives, depending on the number of employees of the company.*

*Their main mission is to present the demands of the employees in order to obtain new benefits for the employees and enter into collective agreements binding on the employer and on the employees.*

*When the trade union is not deemed "representative", it may still appoint a representative of the union section which is granted the same prerogatives as the union representative, but such representative does not have the power to negotiate and enter into collective agreements.*

*The representatives elected or appointed, according to the Labor Code, benefit from "delegation hours" under the Labor Code or collective agreements, to be used during their work time in order to discharge their duties as union representatives. Delegation hours are paid as working hours.*

*Moreover, the employer who intends to dismiss a union representative first must obtain the prior authorization of the administration, irrespective of the grounds for dismissal.*

## HYGIENE AND SECURITY

### ► Obligation of security

*The employer has a duty to provide a safe workplace and ensure that the working conditions comply with the legal requirements of safety and hygiene. This is an obligation "of results", which entails strict liability of the employer in the case of breach.*

*Any employer also must to implement the necessary measures to protect the mental and physical health of his employees and to ensure their safety under pain of civil and criminal liability.*

► **Psychological risks**

*The employer has in particular the obligation to combat psychological risks: stress at work, internal violence (conflicts, hazing, sexual harassment...), external violence, professional exhaustion (burn-out), which often have common interacting factors (workload, lack of organization within the division of the work among the employees, intensification of work, management of the employees).*

*To prevent such risks, the employer has to evaluate them set up indicators of psychological risks that have to be reviewed each year and set up a plan of action in order to reduce those risks.*

► **Moral Harassment**

*Tensions, insults and deterioration of work relationships, unfriendly comments, insinuations, humiliations or behavior with sexual connotations, acts of violence, unjustified criticism: moral harassment constitutes one of the main risks which the employer has a duty to prevent or suppress.*

*Under French law, employees may not be subject to repeated actions of moral harassment resulting in or purporting to damage or degrade the workplace environment, or undermine the employee's rights or dignity, distort its physical moral or mental health, or compromise the employee's professional future.*

*The victim of such harassment may bring an action before civil courts and petition for damages in compensation of the moral damages or injuries suffered.*

*The victim may also apply for the judicial termination of her employment contract, with the financial consequences for the employer.*

► **Work accidents and professional illness / workers' compensation**

*Employees who incur work accidents and professional illnesses benefit from a specific protection under French law.*

*Victims of such accidents or illnesses have their employment contract indefinitely suspended during their medical leave until found fit for duty.*

*Moreover, during this suspension, sick employees subject to workplace accident or professional illness are protected against dismissals, unless they commit gross negligence, or the employer proves that he/she cannot maintain the employment contract for a reason other than the accident or professional illness.*

*A dismissal in breach of this rule is void and the employee may demand his/her reinstatement within the company and, for the period between the termination of the contract and the reinstatement, up to the amount of actual loss in salary (after deduction of the social security indemnities, if paid).*

*The employee may also decide not to request reinstatement and demand to be fully compensated depending on the damages incurred.*

*After such a suspension, once the medical visit finds the employee fit for duty, the employee must be reinstated at the same position, or may be declared unable to return to work by the labor inspection physician. Such a report of unfitness ("inaptitude") consecutive to a work accident or professional illness must be followed by the redeployment of the employee and a specific procedure governed by the Labor Code.*

*With regard to work-related accidents or illnesses, the employee may also apply for the costs incurred for his/her accident or illness be assumed by the social security organizations.*

*After review of such application by the social security organizations, the decision is then notified to the employer, who may challenge it before a specific court.*

*The employee or its successors may also ask for additional compensation when the accident or the illness is due to the inexcusable negligence ("faute inexcusable") from the employer, which is characterized when the employer had or should have known of the dangers and failed to take the necessary measures to protect his/her employees (e.g. asbestos).*

## **COLLECTIVE BARGAINING**

President Macron's Ordinances have reinforced the possibility for companies to negotiate company-wide collective agreements prevailing over those of branch/professional collective agreements. The scope of primacy of the company collective agreement has been extended. Moreover, the Ordinance facilitates the conclusion of company-wide agreements in companies without trade-union delegates.

## BUYING REAL ESTATE IN FRANCE

The purchase of real estate in France typically follows three steps:

### ► Negotiations

*The discussion phase occurs prior to signing an undertaking. In theory, the parties are free to give or withhold consent to the proposed transaction. However, there is an obligation to negotiate in good faith and failure to comply with this obligation may result in damages for losses proven.*

*Once there is agreement on the price and the exact property, a binding contract may be deemed to be formed. It is important, therefore, that parties are cautious not to exchange documents that might give rise to a binding agreement prior to the preliminary contracts intended for this purpose.*

### ► Preliminary Contracts

*There are two types of preliminary contracts: the "promesse unilatérale de vente" (purchase option), and the "promesse synallagmatique de vente" (bilateral undertaking to sell and purchase). Both types are subject to conditions precedent such as the exercise (or waiver) by the local authorities of a right of preemption within a two-month period, the buyer being granted a loan to finance the acquisition, obtaining building permit, or other conditions required by the specific operation.*

*The preliminary contract must provide the agreed sale price or the precise calculation method. A description of the land and building must also be included. In addition, the conditions precedents are determined, and a guarantee payment is usually provided in the amount from 5 to 10% of the purchase price, in order to protect the seller from frivolous purchasers.*

### ► Deed of Sale

*The deed of sale is the document whereby ownership is transferred from the seller to the buyer. The deed of sale contains the terms and conditions provided in the preliminary contract.*

*The transfer in title is only enforceable against third parties as from its registration at the office of the land registrar, although it may be enforceable between the parties as of the date of signature.*

*In order to be registered with the land registrar, the legal instrument must be drafted by and signed before and with a French notary ("notaire"). In France, the notary is the holder of an office conferred by a public authority.*

*The notary has a duty to advise and warn both parties of their respective obligations, and a duty to the French government for collecting all taxes arising out of the sale of the real estate property.*

## COMMERCIAL LEASES

Leases for buildings used for commercial and industrial purposes are covered by the French Commercial Code.

Commercial leases offer significant protection to tenants. A June 2014 statute reinforced the protection of commercial tenants by aligning the rules of commercial leases with rules applicable to residential leases: rent control indexation, inventory of the premises, and preemption right for the benefit of the tenant in the case of sale of the premises.

In addition to those commercial leases, parties are allowed to enter into short-term leases under special circumstances (*convention d'occupation précaire*) or for a duration up to three years (*bail dérogatoire*) avoiding commercial lease rules.

► **Term of the Lease**

*Commercial leases must be at least 9 years in duration. The tenant may terminate the lease at the end of any three year period, by giving six months prior notice. The individual tenant may also terminate when officially taking retirement under the French social security system.*

► **Rent amount**

*The parties have complete discretion in determining the rent, which reflects market conditions and may for example, be determined in part or in whole by reference to a percentage of the turnover generated by the tenant in the leased premises.*

*The lessee typically will pay a guarantee deposit and may be required to provide a bank guarantee to secure payment of rent.*

*The lease may provide for an indexation clause for the rent. Other formulas are possible, such as a review with specific parameters every three years, or even a share in the profits generated by the tenant (the latter being very rare nowadays).*

*If the parties cannot agree on the rent value at renewal or rent review (in the absence of a contractual clause), the law refers to certain elements, such as the characteristics of the premises, its permitted use, the respective obligations of the parties, and prices commonly used in the geographic area.*

► **Termination of the Lease**

*The landlord's ability to terminate the lease is restricted. The tenant has, in principle, the right to obtain either the renewal of the lease at the end of the term, or "fair compensation" corresponding to the loss suffered as a result of not being able to renew must be paid, except where the tenant has committed a material breach of contract. Such indemnity is in theory the value of the ongoing business ("*fonds de commerce*") conducted on the premises plus moving and other relevant costs.*

*The notices of termination followed a very formal process which requires the intervention of a bailiff (*huissier*). Recent legislation added the possibility of giving notice with a registered letter with return receipt.*

► **Renewal of the Lease**

*If notice has not been duly served at the end of a lease term, the lease is deemed to be tacitly renewed for the same term and under the same conditions.*

*However, if the tenant serves a request for renewal (at least six months prior to the end of the term) the landlord has three months within which to decide to accept the offer to renew.*

*If the landlord does not reply within this three months period, the lease is renewed. In such case, or if the landlord accepts the request, the lease is renewed according to the terms and conditions of the expired lease, with only the amount of rent subject to modification.*

## **ZONING AND BUILDING PERMITS**

Any new construction, from private residences to urban development projects, requires a prior permit issued by the local administration, which is subject to zoning rules and regulations, building codes and local ordinances. The permit is delivered by the city where the land concerned by the construction is located.

In addition, changes to existing buildings that increase habitable surface, alter the outside appearance or the structure of a building require a building permit.

However, light work that does not affect the outside appearance of the building may not require a building permit but rather a notification to the city hall. Moreover, if the purpose for which the building is intended to change (for ex: housing, business, handcraft business, industry, industry, storehouse...), a notification of such change of purpose must be given to the city administration.

After construction, the builder or promoter must officially confirm that the construction is consistent with the building permit application and the permit as issued, and request from the city administration a certificate of compliance that confirms the lack of objections to the construction from the town administration

Land is classified as urban, developable land or protected land.

# France | CRIMINAL LAW

A criminal prosecution may be commenced in:

- a. Either by a Public Prosecutor
- b. By a victim through the filing of a complaint which seeks both the initiation of criminal charges and the award of civil damages in the criminal proceedings

In the French criminal system, the prosecuting, investigating and judging functions are maintained separate from one another.

The investigation / fact-finding is conducted by an investigating magistrate (juge d'instruction) when the maximum sentence incurred is more than ten years of prison, when requested by the Public Prosecutor or when there is complaint from the victim.

## PROSECUTION

### ► The Role of the Public Prosecutor

*Public Prosecutors are magistrates (i.e., they have the same training as judges), who work for the Office of the Public Prosecutor (Ministry of Justice), akin to the Attorney General's Office in the USA. A Public Prosecutor's mission is to prosecute criminals on behalf of the general public.*

*In cases where the investigation by a "juge d'instruction" is not mandatory, a Public Prosecutor may carry out a preliminary investigation on his own, with the assistance of the police. The goal of such a preliminary investigation is to ascertain whether violations of criminal statutes have been committed, to collect evidence of such violations and to identify the offender(s). In addition, it gives a basis for the Public Prosecutor in deciding in whether or not to prosecute the case.*

*Investigations made by the police generally involve fact finding reports drawn up describing the facts and the identification of the various persons involved. In particular, police services may question any witness whose testimony may be useful to further investigate. If there are one or more plausible reasons for suspecting that a person has participated in the commission of an offence, such person can be interviewed by the police and kept in police custody ("garde à vue") for a one-time renewable 24-hour period. The person kept in custody is allowed to speak with a lawyer at the beginning of the custody period and at the beginning of the renewed custody period; the lawyer may also be present during the interviews with police officers and agents.*

*If the person has been kept in custody and the evidence gathered seems sufficient to bring proceedings, the Public Prosecutor may refer the persons before the Criminal Court ("Tribunal Correctionnel") by means of a simple citation (summons) or request the start of an investigation.*

*In order to strengthen criminal enforcement for economic and financial matters, a statute of December 6, 2013 created a special Prosecutor for financial matters with national jurisdiction over those matters.*

### ► Investigation by a juge d'instruction

*The juge d'instruction is a specialized judge, member of the Court of First Instance (Tribunal de Grande Instance) who conducts his investigations under the control and supervision of the "Chambre de l'Instruction," an appellate court.*

*The juge d'instruction's role is to determine whether it exists against any person sufficient information warranting that the person or entity be brought to trial before a criminal court. The investigation phase, referred to in French as the "instruction" or "information" is therefore the stage where the case is developed and put in a state that will allow the matter to proceed to trial (known as the "mise en état de l'affaire"). This "mise en état" not only concerns questions of fact and guilt, but also issues of the defendant's background and history (when individuals are concerned).*

*The juge d'instruction is independent from the Prosecutor's office. It is the judge's responsibility to carry out his investigation, not only with a view to finding incriminating evidence, but also exculpatory evidence. In this manner, French criminal proceedings are truly inquisitory in nature rather than accusatory.*

*The juge d'instruction may carry out investigations personally or may, as it is usually the case, designate investigators (police officers) to carry out these measures, which consist generally in searches to seize the necessary documents or items connected with the matter, and the questioning of the persons involved in the case. It should be noted that the "instruction" of a criminal case can be quite a lengthy process.*

#### Experts

Depending on the complexity of the matter, the juge d'instruction may also appoint experts. In addition, the parties have the right to retain their own experts, in order to help them to prepare their defense and better understand the conclusions reached by the court-appointed expert.

#### Convocation

In the context of the judicial inquiry, the juge d'instruction may summon or request the police to question any person connected with the case. The summons to appear before the judge is called a "convocation".

Depending on the evidence, if any, existing against the person to be questioned, said person can be heard under various positions (witness, assisted witness or accused) and entitled to greater or lesser protections.

#### Outcome of the juge

At the close of the investigation, the juge d'instruction can either render (i) an order dismissing the charges ("ordonnance de non-lieu") or (ii) an order allowing the court having jurisdiction to conduct a trial in the matter ("ordonnance de renvoi").

The decision to remand a case for trial does not constitute a decision on the merits.

## TRIAL

The matter may be brought for trial before the criminal court having jurisdiction by the juge d'instruction or by the Public Prosecutor. The trial is likely to be commenced anywhere from 6 months and up to one year following the closing of the instruction.

Please note that the victims may also directly apply the Court (i) through the filing of a summons if the Public prosecutor did not bring the case to a court ("citation directe") or (ii) through a complaint ("constitution de partie civile") if the Public Prosecutor or an investigating magistrate has decided to have the case brought to trial.



► **Summons to Appear and Assistance of Counsel**

*The prosecuted parties will be summoned to a hearing. They are in principle required to appear personally, unless they can show cause (health or serious professional obligations).*

*If they cannot personally attend the hearing, they may be represented by their lawyers if they inform the Court President and provide their lawyers with a special power to represent them before the Court.*

*However, the Court may consider that the presence of these persons is necessary and decide to postpone the hearing to a day when they will be able to be present. In the event the offence is punishable by imprisonment of two or more years, the Court may require their presence by an arrest warrant ("mandat d'amener").*

► **Intervention by the Parties**

**1. The civil parties**

The civil parties are permitted to file written briefs supporting their positions and / or requesting a decision on a specific question. They may also question the accused, witnesses and experts during the trial.

**2. The Public Prosecutor**

During the trial, the Public Prosecutor may question the parties, witnesses and experts. Before the attorneys for the accused speak, the Public Prosecutor makes a closing statement as to the penalties requested against each of the accused.

**3. The accused**

Just like civil parties, the accused are permitted to file written briefs supporting their position and/or requesting a ruling on a specific point. They may be questioned during the trial by the presiding judge, acting either on his own or at the request of the Public Prosecutor or the civil parties. The accused is also entitled to question the civil parties, the experts and the witnesses, and they are always afforded the last word on closing arguments.

► **Rendering of the Judgment - Appeal**

*At the end of the hearing, if the court, given the complexity of the matter, cannot make a decision on the very day, it will set the date on which it will be in a position to render its decision. The accused may request this decision to be translated into a language he can understand.*

*Criminal appeals must be filed within 10 days from the date the judgment is rendered.*

► **Access of the public and of the press**

*Note that the criminal trial is necessarily open to the public, except in very limited circumstances where the conditions for "in chambers" hearings are met (cases involving minors or rape). Media presence is possible, but filming or photographing in the courtroom is prohibited.*

# France | INTELLECTUAL PROPERTY

Intellectual property protection is critical for businesses to maintaining success and development. Defining a strategy to protect, develop and monitor your IP rights is now paramount for most of IP-based businesses.

Without protection of literary and artistic property (copyright) and industrial property, businesses would be unable to protect their rights and reap the full benefits of their inventions and research.

## COPYRIGHT

Under French law, copyright is protected without any formal proceeding. The sole creation of original works of authorship (i.e. reflecting the personality of its creator) is protected by the French Intellectual Property Code.

The Law includes protection of two types of creation:

1. The original creation : copyright
2. The performance of copyright called "droits voisins" ("related rights")

### ► Copyright

*French law is very protective of authors' creations and provides for a wide protection towards any type of creation as long as it fulfills the "originality" requirement. The author legally obtains patrimonial and moral rights.*

*On the patrimonial level, two rights are protected for a period of 70 years after the author's death: reproduction rights (right to make and keep copies, such as the downloading of a file, music, video game, software, etc.) and representation rights (right to show to the public, such as a concert, a streaming process, etc.).*

*The author's patrimonial rights are subject to exceptions (art. L.122-5 of the French Intellectual Property Code), which are restrictively applied by the judge and not as wide as U.S. law's "Fair Use".*

*With his moral rights, the author can obtain legal protection of his name, any use of his creation and his work. The moral rights are inalienable and imprescriptible, which means that the author's heirs can bring an action to protect it indefinitely.*

### ► "Rights" (Droits voisins)

*The so-called "droits voisins" related to the use of the original creation and phonogram producers rights are specific to the French legal system and are protected in a quite similar way as copyright.*

## INDUSTRIAL PROPERTY

Industrial property is divided into two main categories: trademarks and patents. Registration of these rights must be filed with the French Patent and Trademark Office (INPI).

### ► Trademarks

*In France, trademarks, are governed by national, European and international law. To be registered with the INPI, a trademark must not infringe a so-called "prior right" (such as previously registered trademark, a copyright, etc.). Trademarks are protected within the national territory for the designated products and services for a period of 20 years, indefinitely renewable.*

### ► Patents

*Patents grant an inventor the right to exclusive use of the invention. It is the most valuable and costly protection.*

*To be patentable, inventions must be new and involve an inventive step (art. L.611-10 of the Intellectual Property Code).*

*A patent is valid for 10 years non-renewable, and annual fees are to be paid to the INPI to maintain the patent.*

### ► Other Industrial Property Rights

*Designs and Models to be protected must be new and have individual character. Registration must be filed and protection last for five years from the application, renewable up to twenty-five years.*

*The "Controlled Designation of Origin" is a certification granted to indicate the geographical area of origin of specific products. The recently created "Protected Geographical Indications" are granted to indicate the geographical origin of a product made from a special local knowledge or know-how.*

# France | PERSONAL DATA PROTECTION

The processing of personal data in France is subject to the provisions of the Law of January 6, 1978 on Data Processing, Data Files and Individual Liberties (the “Law”).

The Law provides for obligations upon those who decide to process personal data (“data controllers”) and rights in favor of individuals about whom personal data is processed. It also created a very influential data protection Authority, called the CNIL (“Commission Nationale de l’Information et des Libertés”), which provides guidance, interprets the rules, ensures that they are properly implemented through investigations (on site and online) and has the ability to impose penalties on infringers.

## **WHEN DOES THE LAW APPLY?**

The law applies to the processing of personal data (i.e. any information relating to an individual who is identified or identifiable directly or indirectly) carried out by computerized or non-computerized means if the data is intended to be stored in an organized filing system.

Strictly private activities are outside of the scope of the law.

The data protection law applies to data processing operations which are implemented by data controllers who are established on the French territory. It also applies to data controllers who are located outside of the EU if they use data processing means on the French territory, such as a supplier to collect or store personal data (except for mere transit) or cookies in case of a website.

## **LEGAL REQUIREMENTS TO THE PROCESSING OF PERSONAL DATA**

The data must be processed for legitimate purposes and the consent of the relevant individuals to the processing must be obtained unless the processing is justified by a ground listed under the Law (e.g. compliance with a legal obligation, performance of a contract with the individual, the legitimate interest of the data controller, where not incompatible with the interests and fundamental rights and liberties of the individual).

The data controller must process only relevant data in light of the purposes announced to the individual (proportionality test).

The processing of sensitive data (racial and ethnic origins, political, philosophical, religious opinions, trade union membership, health, sexual life, criminal offenses, social security numbers) is either prohibited or subject to stringent restrictions.

### **DUTIES OF DATA CONTROLLERS**

Data controllers must provide a data protection notice to individuals informing them about the specificities of data processing activity, data transfers outside the EU, and how they can exercise their rights (set content requirements).

Formalities with the CNIL must be carried out prior to the launch of the data processing (criminal offense). In most instances, a mere notification can be filed online at [www.cnil.fr](http://www.cnil.fr). However, for more sensitive activities, prior authorization is required (e.g. biometrics, processing which may lead to the exclusion of the individual from the benefit of a contract).

In many instances, employee representatives must be informed or consulted before the employer decides to select a tool processing employee data.

The security of personal data must be preserved, in particular to prevent unauthorized access.

If the data controller entrusts the processing of data to a supplier who processes data on its behalf (“data processor”), the data controller must verify the security measures of the supplier and enter into a written agreement meeting specific legal requirements.

### **RIGHTS OF INDIVIDUALS**

Individuals have the right to object to the processing on legitimate grounds, to direct marketing by post mail or by phone (“opt out”), except when they gave prior consent (“opt in”).

The consent of individuals is required to use certain types of cookies which are not technically useful for the operation of the website.

An individual can request access to the personal data about him/her, obtain a copy in a clear format, require that the data be rectified and deleted if the data is inaccurate, incomplete, equivocal, or out of data.

**INTERNATIONAL DATA TRANSFERS**

While data can be transferred freely within the EU, transfers of personal data outside the EU are prohibited unless they are made to a country providing a sufficient level of protection for personal data (cf. list of the EU Commission or the Safe Harbor list). These transfers must be notified to the CNIL.

In other instances, the CNIL encourages the use of BCR (Binding Corporate Rules), and of the EU Commission's standard contractual clauses. These transfers are subject to the CNIL's prior authorization.

**ENFORCEMENT**

The CNIL is a very active data protection authority. It carries out around 400 on-site investigations each year and since 2014, can conduct online investigations. The CNIL may impose civil fines ranging from warnings, "cease and desist" injunctive orders, fines (up to 150,000 Euros per occurrence), terminations of data processing authorizations; penalties can be made public. Most breaches of the Law also constitute criminal offenses which trigger sanctions with a maximum of five years of imprisonment and fines up to 300,000 Euros (multiplied by 5 if committed by a legal entity).

# France | COMPLIANCE

During the year 2017, tighter compliance and corporate social responsibility regulations were introduced in the French legislative landscape.

Through law n° 2016-1691 of December 9, 2016 on transparency, fight against corruption and modernization of the economy, now dubbed «Sapin II», compliance became a legal requirement for companies that employ at least 500 employees or belong to any group whose parent company's headquarters is located in France, which has at least 500 employees, and whose annual turnover exceeds €100 million.

Hence, these companies are required to implement a compliance program to identify and prevent acts of corruption or influence peddling ("traffic d'influence"), occurring in France or abroad which must include:

1. An anti-corruption Code of Conduct
2. Corruption risk mapping by business sector and geographic areas
3. Adequate third party due diligence procedures
4. An internal whistleblowing system
5. Training sessions for executives or employees in high risk positions
6. Disciplinary procedures for employees suspected of breaches of the Code of Conduct
7. Appropriate internal and external accounting controls
8. Internal controls and follow-up procedures to assess the efficiency of the compliance program.

Failure to comply with the obligation is sanctionable by a fine of up to €1 million for legal entities and €200,000 for individuals.

Moreover, by contrast to whistleblower provisions of the Sarbanes-Oxley Act applicable to publicly-traded companies in the United States, including all wholly-owned subsidiaries, the Sapin II statute establishes a dedicated status for whistleblowers and mandates companies having more than 50 employees to implement an internal whistleblowing process accessible to any employee of the company as well as third parties (individuals or entities) such as subcontractors, suppliers or customers.

Lastly, on the level of corporate social responsibility, pursuant to the law on the duty of vigilance of parent and ordering companies of March 27, 2017, companies employing at least 5,000 employees in France or at least 10,000 employees worldwide (including employees of their subsidiaries) are required to implement

and publish a “vigilance plan” which implements reasonable monitoring measures to adequately identify in France and abroad risks and prevent serious violations of human rights and fundamental freedoms, risks to health, safety or the environment regarding not only their own activities, but also those of their subsidiaries, subcontractors and suppliers with which a long term commercial relationship exists.

The statute on the duty of vigilance covers much broader issues than corruption; however, the vigilance plan resembles in many respects to the law Sapin II compliance program including:

Although the Conseil d’Etat removed the initial civil fine penalty attached to the vigilance statute, damages resulting from a company’s failure to implement a vigilance plan might trigger its civil liability.

The aforesaid provisions should significantly change the way of doing business and strengthen risk management for activities undertaken in France.

1. Risk mapping aimed at identifying, analyzing and classifying such risks
2. Due diligence procedures of the situation of the subsidiaries, subcontractors and suppliers
3. Appropriate actions in order to mitigate the risks and prevent serious harm
4. A whistleblowing system and a monitoring process of the measures taken and an evaluation of their efficiency



2017 highlights on some new EU or national (French) legislation in life sciences' sector include:

► **Regulation (EU) 2017/745 of the European Parliament and of the Council dated April 5, 2017 on medical devices**

*This new Regulation shall be effective in 2020 for new Medical Devices and at the latest by 2025 (and in any case prior to the expiration of the CE certificates validity period) for devices already marketed.*

*The text is more specific on the definition of "software used as a Medical Device".*

*Software for general purposes, even when used in a healthcare setting, or software intended for life-style and well-being purposes is not a medical device. The qualification of software, either as a device or an accessory, is independent of the software's location or the type of interconnection between the software and a device.*

*This leads to a clarification of the classification of the so-called "borderline products", such as software as Medical Devices.*

*The main impact for companies is the harmonization of national processes under the Regulation.*

*The companies will now have to appoint a compliance manager and stricter conditions are imposed for issuing the certificate: obligation to provide a more detailed technical file and the obligation to do relevant clinical investigations for all class III medical advices.*

*It is also relevant to note that a unique identification system (IUD) is instituted in order to ensure the traceability of medical devices. IUD also participates in the post-market safety-related activities for devices, with improved incident-reporting, targeted field safety corrective actions and better monitoring by competent authorities. It should also help reduce medical errors and fight against counterfeit devices.*

*With regards to the classification of Software used as Medical Devices, the principles are the same:*

**With regards to the classification of Software used as Medical Devices, the principles are the same:**

- The classification is governed by the intended use
- The classification is distinct for association of medical devices
- Software as a medical device is classified in the same way as the medical device it directs or operates
- The review now takes into account the use on the most critical part of the body
- If more than one rule apply, the stricter classification is retained

**Three main changes are observed nonetheless:**

- An Independent software can be classified independently
- To allow a direct diagnostic it is deemed to be the equivalent of producing the diagnostic or the decisive information itself
- "Temporary interruptions" in the use of the device do not change the criteria of the "permanent use")

*The general trend is now leaning towards stricter standards. For example a class III for breast implants, DMI in contact with the spinal cord, medical devices integrating nanomaterials, medical devices with diagnostic functions, etc.*

*This new trend has an impact on the number of medical devices in the I class, which will from now on more often be classified in the IIa or even IIb classes.*

► **Regulation No 536/2014 on clinical trials on medicinal products for human use**

*The Clinical Trials Regulation aims at creating an environment that is favorable for conducting clinical trials, with the highest standards for patient safety, for all EU Member States, with an increased transparency as regards to clinical trials and their outcomes. It has been adopted in 2014 and may come into force in 2018.*

*The main characteristic of the new Regulation is a streamlined application procedure via a single entry point, the EU portal. As a consequence, applicants only have to prepare a single set of documents to submit the application defined in Annex I of the Regulation.*

*The procedure for the assessment of applications for clinical trials is harmonized between Member States, with strictly defined deadlines for such assessment. The ethics committees are involved in the assessment procedure in accordance with the national laws of the Member State but within the overall timeline defined by the Regulation. The principle of the tacit agreement is extended to the whole authorization process.*

*Union conducts controls in Member States and third countries to ensure that clinical trials rules are being properly supervised and enforced.*

*Clinical trials conducted outside the EU, but referred to in a clinical trial application within the EU, will have to comply with regulatory requirements that are at least equivalent to those applicable in the EU.*

► **French changes in health sunshine laws: Law 2016-41, January 26, 2016, Ordinance 2017-49, January 19, 2017, Decree n° 2016-1939, December 28, 2016**

*A new set of statutes have been adopted to reinforce the prevention of conflicts of interests in health sector.*

*This new disclosure regime is effective since July 1, 2017, and the new prohibition system for benefits will be effective on July 1st, 2018.*

*One of the major points of the reform is to merge in the same section of the French Public health Code the various statutes. This merger enables the harmonization between the processes for disclosing benefits and the publication of certain information concerning agreements concluded between health industry firms and health sector actors (health professionals, health policy-makers, associations, etc.).*

*It is important to notice that the disclosure requirement extends to agreements relating to the cosmetic industry, and that the regulations applies to health products manufacturers that are not covered by the French state health insurance, which implies that number of firms previously not in the scope of the obligation are now covered by the disclosure rules.*

**The Code now states that are not considered as prohibited benefits:**

- The compensation of an activity or work
- The copyrights of a medicinal product,
- Commercial benefits related to commercial agreements, or
- benefits under a threshold not yet defined (but expected to be around €10).

**Benefits to health professionals that are not prohibited and subject to obligation of declaration or authorization are:**

- Fair compensation for research activities, scientific assessment, advice
- Gifts to finance research activities, or professional associations
- Reasonable accommodation and housing costs
- Funding of continuing vocational training and education

*Every benefit which is not prohibited should lead to the conclusion of an agreement, and be published on the dedicated website.*

*Companies are now required to obtain prior approval from the relevant competent authority for agreements providing benefits above a threshold to be defined by ministerial order (probably €10).*

*Failure to comply with the approval and disclosure requirements may lead to criminal penalties and fines.*



H

Hong Kong

Charltons

# Charltons

—  
Hong Kong

📍 12th Floor Dominion Centre  
43-59 Queen's Road East  
Hong Kong

☎ (852) 2905 7888

[juliacharlton@charltonslaw.com](mailto:juliacharlton@charltonslaw.com)

[www.charltonslaw.com](http://www.charltonslaw.com)

## • Framework

The Companies Ordinance (Cap. 622) (the “Companies Ordinance”) governs companies incorporated in Hong Kong and overseas companies registered in Hong Kong. Hong Kong’s first Companies Ordinance was enacted in 1865 and was based upon the UK Companies Act 1862. It has since been revised to take into account changing practices in the commercial world, in particular in relation to transparency and disclosure of corporate transactions. The revisions are often similar to those introduced in other common law jurisdictions, such as Australia, Canada, Malaysia, New Zealand and Singapore, all of which have adopted the UK corporate model. When interpreting Hong Kong company law, Hong Kong courts may also refer to case law in these jurisdictions. The current Companies Ordinance came into force in March 2014. The previous Companies Ordinance (Cap. 32) was retitled as the “Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32)” (the “C(WUMP)O”). The core provisions affecting the operation of companies under the previous Companies Ordinance were repealed, except those provisions relating to the winding-up and insolvency of companies and the prospectus regime governing public offerings of companies’ shares and debentures.

## • Types of Business Structure

All entities doing business in Hong Kong, regardless of their corporate form, are required to obtain a business registration certificate from the Inland Revenue Department. Some are also required to register with the Companies Registry for incorporation. The application and registration procedures differ depending on whether the business is a sole proprietorship, a partnership (or other unincorporated body), a Hong Kong-incorporated company or an overseas company.

### ► Sole Proprietorship or Partnership

*Sole proprietorships or partnerships are required to obtain a business registration certificate from the Inland Revenue Department, but beyond this there are few formalities with which they must comply. Whilst sole proprietorships and partnerships are not required to disclose information to the public, they must nevertheless keep accounts and are liable for profits tax.*

*Partnerships are governed by the Partnership Ordinance. Both sole proprietorships and partners are liable for the debts of their business with unlimited liability. Whilst partnerships may be formed under the Limited Partnership Ordinance, in practice this ordinance is rarely used.*



## ► Company

### 1. Limited company incorporated in Hong Kong

To incorporate a limited company in Hong Kong, certain documents must be filed with the Registrar of Companies and a business registration certificate must subsequently be obtained from the Inland Revenue Department. Under the one-stop company and business registration service jointly launched by the Companies Registry and the Inland Revenue Department, if the required incorporation documents and prescribed fees are submitted to the Registrar of Companies, a limited liability company can collect both its business registration certificate (issued by the Inland Revenue Department) and its certificate of incorporation (issued by the Companies Registry) from the Companies Registry once its incorporation application has been approved. Following incorporation, limited companies are subject to continuing obligations as set out in the Companies Ordinance, which include a requirement to submit various documents to the Registrar of Companies, such as annual returns, notices of change of directors and of alteration of a company's share capital.

In general, a company incorporated in Hong Kong must comply, inter alia, with the following continuing obligations:

- Maintenance of registers (including registers of members, charges, directors and secretaries)
- Maintenance of proper accounting records
- Holding an annual general meeting at least once every financial year (but this may be dispensed with in certain circumstances, e.g. if everything that is required to be done at the meeting is done by a written resolution and copies of the documents required to be laid or produced at the meeting are provided to each member on or before the circulation date of the written resolution)
- Delivering to the Registrar of Companies an annual return within 42 days after the company's return date every year. The company's return date is the anniversary of its incorporation (for private companies), 6 months after the end of its accounting reference period (for public companies) or 9 months after the end of its accounting reference period (for companies limited by guarantee)
- Preparation of the company's financial statements and directors' report by company's directors
- Laying before the company in annual general meeting and sending to every member a copy of the reporting documents (i.e. financial statements, directors' report and auditor's report)
- Delivery of particulars of certain charges or security created to the Registrar of Companies
- Notification to the Registrar of Companies when there are changes in certain details and particulars

All documents filed with the Registrar of Companies are open to public inspection

### 2. Overseas company registered as a non-Hong Kong company in Hong Kong

Overseas companies that intend to establish an office in Hong Kong that do not wish to create a Hong Kong-incorporated subsidiary may register as non-Hong Kong companies under Part 16 of the Companies Ordinance.

Within one month after establishing a place of business in Hong Kong, an overseas incorporated company must register as a non-Hong Kong company under Part 16 of the Companies Ordinance by registering certain documents with the Registrar of Companies. It is also required to obtain a business registration certificate from the Inland Revenue Department.

A non-Hong Kong company registered under Part 16 of the Companies Ordinance must report to the Registrar of Companies any subsequent changes to its name, directors, secretaries, authorised representatives, memorandum and articles of association, the address of its principal place of business and registered office, in each case within one month of the change by submitting the prescribed forms. The creation of a charge on property situated in Hong Kong and any existing charge on acquired property situated in Hong Kong must be registered with the Registrar of Companies. Every year, a non-Hong Kong company must submit to the Registrar of Companies an annual return and a copy of its annual accounts (if applicable). Such obligations will cease if the company ceases to have a place of business in Hong Kong.

## • Types of Companies

### ► Private companies

*In general, a company incorporated in Hong Kong must comply, inter alia, with the following continuing obligations:*

- Restricts the right to transfer its shares
- Limits the number of its members to 50
- Prohibits the company inviting members of the public to subscribe for its shares or debentures

*A private company does not need to file financial statements with its annual return.*

### ► Public companies (non-listed)

*Any company which does not include in its articles of association the three restrictions required for the establishment of a private company under the Companies Ordinance is a public company. A public company is subject to more disclosure requirements than a private company, e.g. a public company must submit to the Registrar of Companies its reporting documents (financial statement, directors' report and auditor's report) which are open to inspection by the public. At the same time, a public company is subject to more stringent restrictions under the Companies Ordinance than a private company.*

### ► Listed companies

*Listed companies in Hong Kong are companies listed on one of the two boards operated by the Stock Exchange of Hong Kong Limited (the "Exchange"), namely, the Main Board and the Growth Enterprise Market ("GEM"). The Main Board caters for companies with a profitable operating track record or that are able to meet alternative financial standards. It is designed to give these companies an opportunity to raise further funds from the market in order to finance future growth. GEM, on the other hand, caters for small and medium sized companies and has lower admission criteria. The majority of companies listed in Hong Kong are listed on the Main Board.*

*While a listing offers advantages and opportunities such as providing easier and greater access to new or additional capital, a listed company is subject to more stringent ongoing compliance obligations. In addition to the Companies Ordinance, listed companies are governed by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (or the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited), as well as the Securities and Futures Ordinance (Cap. 571) and the C(WUMP)O.*

## ► Limited companies

The Companies Ordinance provides that limited companies can be either limited by shares or limited by guarantee.

### 1. Companies limited by shares

The articles of association of a company limited by shares will specify the maximum number of shares that it may issue. Liability of members of a company limited by shares is limited by the articles to any amount unpaid on the shares held by the members. Shares are usually fully paid when they are issued, in which case, even if the company is wound up and is unable to pay its debts, the members would not be liable to pay those debts.

Where shares have only been partly paid for on issue, however, a member is liable to pay the agreed balance according to the terms of issue or, if there are no terms, when called upon to do so. In the event of a company being wound up, members are liable to contribute to the assets of the company to an amount sufficient for payments of its debts and liabilities, and the costs, charges, and expenses of the winding up, and for the adjustment of the rights of the members among themselves, but their maximum contribution will be the amount unpaid on their shares.

### 2. Companies limited by guarantee

The liability of the members of a company limited by guarantee is limited by its articles to the amount that they undertake to contribute to its assets in the event of the company being wound up. The articles must specify the amount each member will contribute to the company's assets for the payment of (a) the company's debts and liabilities, (b) the costs, charges and expenses of winding up, and (c) the adjustment, among the members, of their rights. A company limited by guarantee must not have a share capital. It is commonly used when there is no intention to distribute the company's profits to its members and the members therefore do not need to hold shares. Companies limited by guarantee are typically used by charities and quasi-charitable organisations such as schools and hospitals, but is only a suitable corporate form if the company does not need an initial share capital.

Any provision in the articles of a company limited by guarantee, or in any resolution of the company, which purports to give any person a right to participate in its divisible profits, otherwise than as a member, will be void.

## ► Companies without limited liability

A company is an unlimited company if there is no limit on the liability of its members. Unlimited companies must be formed with a share capital. If an unlimited liability company goes into liquidation, the members will be liable to pay whatever price they agreed for their shares; where this amount is inadequate to satisfy the debts and liabilities of the company together with the costs of winding-up, the members must contribute rateably according to their shareholdings.

### ► Dormant Companies

A private company may pass and deliver to the Registrar of Companies a special resolution declaring that the company will become dormant. Dormancy enables a private company to remain a registered company while at the same time being exempt from the requirements to hold annual general meetings, deliver annual returns, prepare financial statements and directors' reports, and appoint an auditor. Thus, the cost of maintaining a dormant company can be significantly lower than the cost of maintaining an active company.

A company ceases to be dormant if it delivers a special resolution declaring that the company intends to enter into an accounting transaction to the Registrar for registration, or if there is an accounting transaction in relation to the company. An accounting transaction is a transaction required by the Companies Ordinance to be entered in the company's accounting records, except the payment of certain fees.

## • Share Capital

The current Companies Ordinance which came in to force in 2014 adopts a mandatory system of no-par for all Hong Kong companies with a share capital and abolished the concept of par (or nominal) value of shares. The Companies Ordinance does not specify a minimum or maximum amount of authorised or issued share capital for either a public or a private company. The articles of a company with a share capital may state the maximum number of shares that the company may issue. A company may issue shares with preferred, deferred, redemption or other special rights; or with any restrictions (whether in regard to dividends, voting, return of capital or otherwise) that the company may from time to time by ordinary resolution determine. If a company issues only one type of shares, the shares are presumed to be ordinary shares.

Under the Companies Ordinance, Hong Kong companies must have at least one member and that one member may be a nominee of the beneficial owner. The member need not be resident in Hong Kong and can be an individual or a corporation.

In Hong Kong, companies are typically incorporated with a share capital of HK\$10,000 divided into 10,000 shares of HK\$1 each.

## • Rights of Shareholders

Although a company's board of directors has the power to manage a company and make day-to-day decisions, the Companies Ordinance reserves certain matters for the decision of a company's shareholders. Decisions reserved for shareholders include:

- At the annual general meeting (or a general meeting, where the company is not required to hold an annual general meeting or has dispensed with holding its annual general meeting under the Companies Ordinance), appointing auditors for the forthcoming year
- Alterations to the company's articles of association
- Changing the name of the company
- Giving financial assistance for the purchase of the shares of the company (shareholders' approval is not required where the assistance does not exceed 5% of the paid-up share capital and reserves of the company)
- Buying back the company's own shares
- Granting the directors power to allot shares
- Reducing the capital of the company
- Removing the company's directors from office
- Petitioning the court to wind up the company

#### ► **Minority shareholder protections**

The Companies Ordinance provides for certain rights and protections for minority shareholders. Some of these protections include:

- Certain decisions of a company requiring a special resolution also require the approval of the court (i.e. reduction in a company's share capital requires confirmation by the court, unless the special resolution is supported by a solvency statement)
- The court may make an order if, on a petition by a member of a company, it considers that (i) the company's affairs are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of one or more members, or (ii) an actual or proposed act or omission of the company is or would be so prejudicial
- Directors must call a general meeting if the company has received requests from members representing at least 5% of the total voting rights of all the members having a right to vote at general meetings
- A company is required to circulate a statement to members in relation to business to be dealt with at a general meeting, where the company has received requests to do so from (i) members representing at least 2.5% of the total voting rights of all the members who have a relevant right to vote, or (ii) at least 50 members who have a relevant right to vote
- The Financial Secretary may appoint a person to investigate a company's affairs on application by at least 100 members or members holding at least 10% of the shares issued (where the company has a share capital), or on application by at least 10% of the persons on the company's register of members (where the company does not have a share capital)
- Any member may bring an action in respect of misconduct (fraud, negligence, breach of duty or default in compliance with any Ordinance or rule of law) committed against a company
- Any member may petition for the company to be wound up by the court

## • Directors

### ► Requirements

*Public companies must have at least two directors, and private companies must have at least one director. In the case of a private company that is not a member of a group of companies that includes a listed company, a body corporate can be appointed as a director, but it must have at least one director who is a natural person. Under the Companies Ordinance, a director can be of any nationality, must have attained the age of 18 and must not have been disqualified from acting as a director. When a company appoints a director, the company must send a specific form to the Registrar of Companies of such appointment. This must set out the director's name and usual residential address and the number of his identity card or passport, and must include a statement that the director accepts the appointment and has attained 18 years of age which must be signed by the director.*

### ► Duties of directors of a company

Directors of companies owe a number of duties, which are based on the principle of showing the utmost good faith toward the company. Generally, directors' duties are owed only to the company itself; directors have been held to owe fiduciary duties to individual shareholders only in limited circumstances. Fiduciary duties of directors, which are generally based on equitable principles, mainly include:

- A duty to act in good faith in the interests of the company
- A duty to exercise powers for a proper purpose for the benefit of members as a whole
- A duty to avoid actual or potential conflicts of duty and interest

Directors also owe a duty of reasonable care, skill and diligence to the company, which is codified in the Companies Ordinance. The Companies Ordinance requires a director to exercise reasonable care, skill and diligence, meaning the care, skill and diligence that would be exercised by a reasonably diligent person with:

- The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (an objective test)
- The general knowledge, skill and experience that the director has (a subjective test)

In addition to the general duties listed above, "A Guide on Directors' Duties" issued by the Companies Registry also includes the following general directors' duties:

- A duty not to delegate powers except with proper authorisation and a duty to exercise independent judgement
- A duty not to enter into transactions in which directors have an interest except in compliance with the requirements of the law
- A duty not to gain advantage from the use of the position as a director
- A duty not to make unauthorised use of a company's property or information
- A duty not to accept personal benefit from third parties conferred because of a position as a director
- A duty to observe the company's constitution and resolutions
- A duty to keep accounting records.

Directors of companies listed on the Exchange must also comply with their duties and obligations under the Exchange's Listing Rules and the Corporate Governance Code in Appendices 14 and 15 of the Main Board and GEM Listing Rules, respectively. Directors who breach their duties and obligations as a director may be liable to civil or criminal proceedings and may be disqualified from acting as a director.

## • Dissolution of a company

A company may be dissolved by the following methods:

- A court order to facilitate an amalgamation or reconstruction of companies
- Striking off the name of a company from the register of companies by the Registrar of Companies
- Deregistration of defunct private companies
- A winding up

### ► Deregistration of defunct private companies under the Companies Ordinance

A private company may make application to the Registrar of Companies for deregistration in accordance with Section 750 of the Companies Ordinance if:

- All the members of the company agree to the deregistration
- The company has not commenced operation or business, or has not been in operation or carried on business during the 3 months immediately before the application
- The company has no outstanding liabilities
- The company is not a party to any legal proceedings
- The company's assets do not consist of any immovable property situate in Hong Kong
- If the company is a holding company, none of its subsidiary's assets consist of any immovable property situate in Hong Kong
- The company has obtained a written notice from the Commissioner of Inland Revenue stating that the Commissioner has no objection to the company being deregistered

### ► Winding up

A company may be wound up:

- By the court, i.e. a compulsory winding up
- Voluntarily, either as:
  - A members' voluntary winding up
  - A creditors' voluntary winding up

**1. Compulsory winding up.** A company may be wound up by the court in the following circumstances:

- If a special resolution has been passed by the company that it should be wound up by the court
- If the company does not commence its business within one year from its incorporation, or suspends its business for a whole year
- If the company has no members
- If the company is unable to pay its debts. A company is deemed to be unable to pay its debts if:

A creditor whose debt exceeds HK\$10,000 serves a notice on the company requiring payment and is not paid within three weeks

An execution in favour of a creditor of the company is returned unsatisfied in whole or in part

The court is satisfied that the company cannot pay its debts, taking into account its contingent and prospective liabilities

- if the articles of association of the company provide that on the occurrence of certain events the company is to be dissolved, and such events have occurred
- if the company is being carried on for an unlawful purpose or any purpose lawful in itself but which cannot be carried out by a company
- if the court is of the opinion that it is just and equitable that the company should be wound up
- if throughout a period of not less than six months ending on the date of the winding-up petition, the company has not had:

in the case of a private company, at least one director

in case of a public company, at least two directors

A secretary

**2. Voluntary winding up.** Section 228(f) of the C(WUMP)O provides that a company may be wound up voluntarily:

- When the period, if any, fixed by the articles for the duration of the company expires, or an event which determines its existence occurs, and the company resolves (by ordinary resolution) to be wound up voluntarily
- If a special resolution has been passed by the company that it should be wound up voluntarily
- If the directors of the company or, in the case of a company having more than two directors, the majority of the directors, make and deliver to the Registrar of Companies a winding-up statement under Section 228A of the C(WUMP)O

*A company may be dissolved by a members' voluntary winding-up provided that the company is solvent and is able to pay its debts within 12 months of the commencement of winding-up. During the process of winding-up, the company is required to comply with all statutory obligations before the winding-up is completed, including but not limited to, settling the business registration fee, filing annual returns with the Companies Registry. If a company has been put into a members' voluntary winding-up and the liquidators are subsequently of the opinion that the company will not be able to pay its debts in full within the period stated in the certificate of solvency, they must summon a meeting of the creditors and lay before the meeting a statement of the assets, debts and liabilities of the company, i.e. the winding-up is converted into a creditors' voluntary winding up.*



► **Liability of the members of the company**

In the event of a company being wound up, every past and present member is liable to contribute to the assets of the company an amount sufficient to pay:

- The debts and liabilities of the company
- The costs, charges, and expenses of winding-up
- For the adjustment of rights between the members

This is subject to qualifications in relation to companies incorporated with limited liability:

- In a company limited by shares, no contribution is required from any past or present member which exceeds the amount, if any, that is unpaid on his shares
- In a company limited by guarantee, no contribution is required which exceeds the amount which was undertaken to be contributed in the event of the company being wound up.

# Hong Kong | TAX LAW

## OVERVIEW OF TAX SYSTEM

The Hong Kong tax system is relatively simple in comparison with some of the more complicated systems in other countries. In Hong Kong, there are three separate direct taxes which are levied under the Inland Revenue Ordinance (Cap. 112) (the “IRO”). The three taxes are: profits tax, salaries tax and property tax. The ambit of the IRO is limited territorially and it is only income with a Hong Kong source which, by and large, is subject to tax.

## PROFITS TAX

- 1. The scope of the charge:** Persons, including corporations, partnerships, trustees and bodies of persons carrying on any trade, profession or business in Hong Kong are chargeable to profits tax on the assessable profits arising in or derived from Hong Kong from such trade, profession or business. No distinction is made between residents and non-residents. A resident may therefore derive profits from abroad without being subject to tax; conversely, a non-resident may be chargeable to tax on profits arising in or derived from Hong Kong. Whether a business is carried on in Hong Kong and whether profits are derived from Hong Kong are largely questions of fact. However, some guidance on the principles applied can be found in cases which have been considered by the courts in Hong Kong and in other common law jurisdictions.
- 1. The basis of assessment:** Tax is charged on the assessable profits for a year of assessment. The assessable profits for a business which makes up annual accounts are calculated on the profits of the year of account ending in the year of assessment. In the year of assessment itself, a provisional tax is required to be paid based on the profits assessed for the preceding year. The provisional payment is applied in the first instance against profits tax payable on assessable profits for that year of assessment when agreed in the following year. Any excess is then applied against the provisional profits tax payable for that succeeding year.
- 1. Tax rates:** The tax rates for profits tax applicable to corporations are as follows:

Year of Assessment	Tax Rate
2008/09 onwards	16.5%

**Note 1:** 75% of the profits tax is waived subject to a ceiling of HK\$20,000 per case for 2014/15 and onwards, HK\$10,000 per case for 2013/14 and 2012/13, and HK\$12,000 per case for 2011/12.

The tax rates for profits tax applicable to corporations are as follows:

Year of Assessment	Tax Rate
2008/09 onwards	15%

**Note 2:** 75% of the profits tax is waived subject to a ceiling of HK\$20,000 per case for 2014/15 and onwards, HK\$10,000 per case for 2013/14 and 2012/13, and HK\$12,000 per case for 2011/12.

**4. Exemptions and deductions:** dividends from a corporation which is subject to Hong Kong profits tax, as well as amounts already included in the assessable profits of other taxpayers chargeable to profits tax, are not included in the assessable profits of the recipient.

In general, all expenses, to the extent to which they have been incurred in the production of chargeable profits, are deductible. They include (but are not limited to):

- Rent paid by any tenant of buildings or land occupied for the purpose of producing the assessable profits
- Bad and doubtful debts (subject to certain rules)
- Repairs of premises, plant, machinery or articles... used in producing the profits
- Expenditure for registration of a trademark, design or patent and expenditure on the purchase of patent rights or rights to any know-how for use in Hong Kong in the production of assessable profits
- Expenditure on research and development (subject to certain rules)

**5. Tax incentives:** tax incentives are available in certain specific areas and these incentives include (but are not limited to):

- Immediate writing-off is allowed for capital expenditure on plant and machinery specifically and directly related to manufacturing processes, and on computer hardware and software
- Capital expenditure on refurbishment of business premises is allowed to be written off over five years of assessment
- Exemption from payment of tax on interest derived from any deposit placed in Hong Kong with an authorised institution (not applicable to interest received by or accrued to a financial institution)
- Accelerated deduction for capital expenditure on specified environmental protection facilities from year of assessment 2008/09 and onwards. For machinery or plant, 100% deduction will be allowed for the capital expenditure incurred. For installations forming part of a building or structure, 20% deduction will be allowed for each year in five consecutive years
- 100% deduction for capital expenditure on specified environmental-friendly vehicles from year of assessment 2010/11 and onwards

**6. Loss relief:** losses incurred in an assessment year can be carried forward and set off against assessable profits in subsequent assessment years.

**7. Books and records:** all persons who carry on business in Hong Kong must keep sufficient records, in English or Chinese, of their income and expenditure to enable their assessable profits to be readily ascertained. There are statutory requirements to record certain specified details of every business transaction. Business records must be retained for at least 7 years after the date of the transaction to which they relate. Any person who fails to keep sufficient records may be subject to a fine of HK\$100,000..

## SALARIES TAX

1. **The scope of the charge:** salaries tax is charged on all income arising in or derived from Hong Kong from an office, employment or pension. In determining whether income "arises in or is derived from Hong Kong", it is necessary to establish where the employment, i.e. the source of income, is located. "Income arising in or derived from Hong Kong from any employment" includes all income derived from services rendered in Hong Kong, without in any way limiting the meaning of the expression.
2. **The basis of assessment:** liability to salaries tax is based on the chargeable income of the year of assessment, but the total amount of income for the year cannot be determined until the year is past. Accordingly, the Inland Revenue Department will first demand payment of provisional salaries tax during the year of assessment and then make adjustments in the following year. Any provisional tax paid for a year of assessment is applied first against the salaries tax payable on the income for that year and if there is excess, the excess is applied against the following year's provisional tax liability.
3. **Income of husband and wife:** a married person is responsible for all aspects of his or her own salaries tax affairs including lodgement of returns and payment of tax assessed. However, if the total tax liability of a married couple under two separate assessments is greater than it would have otherwise been when their incomes are aggregated, they may elect to be jointly assessed.
4. **Deductions allowed:** the following deductions are allowed
  - Expenses wholly, exclusively and necessarily incurred in the production of assessable income, not being expenses of a private, domestic nature or capital expenditure
  - Donations paid to approved charities if the amount is not less than HK\$100 and with the limitation that such allowance should not, from the year of assessment 2008/09 onwards, exceed 35% (25% for years of assessment 2005/06 to 2007/08) of the income after allowable expenses and depreciation allowances
  - Self-education expenses paid on fees (including tuition and examination fees) in relation to a 'prescribed course of education', or on fees in respect of an examination set by specified education providers or trade, professional or business associations. The course and examination must be for gaining or maintaining a qualification for use in any employment

A 'prescribed course of education' is a course undertaken at an education provider, specified education providers, such as a university, college, school, technical institution, training centre, or a training or development course provided by a trade, professional or business association or one accredited or recognised by specified professional bodies or institutions.

The amount deducted should exclude any amount that has been or will be reimbursed by the employer or any other persons. The maximum deduction is as follows:

Year of Assessment	Maximum deduction (in HK\$)
2001/02 to 2006/07	\$40,000
2007/08 and onwards	\$60,000

- Elderly residential care expenses paid by the person or his/her spouse to a residential care home in respect of the person's or his/her spouse's parent or grandparent. To be eligible for the deduction, the parent/grandparent must be 60 years old or above at any time in the year of assessment, unless he/she is entitled to claim an allowance under the Government's Disability Allowance Scheme. The residential care home must also be situated in Hong Kong and be licensed or exempted from licensing under the Residential Care Homes (Elderly Persons) Ordinance (Cap.459) or the Residential Care Homes (Persons with Disabilities) Ordinance (Cap.613), or be a nursing home registered under the Hospitals, Nursing Homes and Maternity Homes Registration Ordinance (Cap.165).

Should the deduction be allowed to a person, he or any other person is not entitled to claim dependent parent and grandparent allowance and additional dependent parent and grandparent allowance for the same parent/grandparent for the same year of assessment. The maximum deduction for each parent or grandparent is as follows:

<b>Year of Assessment</b>	<b>Maximum deduction (in HK\$)</b>
2012/13	\$76,000
2014/15 and 2015/16	\$80,000
2016/17 and onwards	\$92,000

- A taxpayer can, for any 15 years of assessment (not necessarily consecutive), claim deductions of HK\$100,000 (maximum) a year for "home loan interest" paid on a home loan for the acquisition of a property unit which must be situated in Hong Kong and must be used as his/her place of residence during the year of assessment.
- For mandatory contributions paid to a mandatory provident fund ("MPF") scheme by a taxpayer as a self-employed person, the maximum deduction for each year of assessment is:

<b>Year of Assessment</b>	<b>Maximum deduction (in HK\$)</b>
2013/14	\$15,000
2014/15	\$17,500
2015/16 and onwards	\$18,000

- Contributions paid to a recognised occupational retirement ("ROR") scheme are subject to the following restrictions:
  - a. The amount deductible is the lesser of the actual amount contributed to the ROR scheme or the amount of mandatory contribution that person would have been required to pay had that scheme been a MPF scheme
  - b. The maximum deduction for each year of assessment is:

<b>Year of Assessment</b>	<b>Maximum deduction (in HK\$)</b>
2013/14	\$15,000
2014/15	\$17,500
2015/16 and onwards	\$18,000

## PROPERTY TAX

- 1. The scope of the charge:** property tax is charged on the owners of land and/or buildings in Hong Kong and is computed at the standard rate on the net assessable value of the property. The standard rate is 16% for years of assessment 2005/06 to 2007/08 and 15% from year of assessment 2008/09 and onwards.
- 2. The basis of assessment:** the assessable value is computed by reference to the actual consideration payable to the owner in respect of the right of use of the property. Examples of consideration to be included in the assessable value are gross rent received or receivable, payment for the right of use of premises under licence, lump sum premium, service charges or management fees paid to the owner, and the owner's expenditure (e.g. repairs) borne by the tenant. The net assessable value is the assessable value (after deduction of rates agreed to be paid and paid by the owner and irrecoverable rent, but not other payments e.g. government rent and management fee) less a 20% statutory allowance for repairs and outgoings. However, any sums previously deducted as irrecoverable and then recovered should be treated as consideration in the year of recovery.

## COMPLETION OF TAX RETURN

Tax Return-Individuals is to be used by an individual to report all his employment income, profits from sole proprietorship businesses and rental income from solely owned properties. Owners of jointly-owned properties who receive rental income are required to file property tax returns. For partnerships and corporations, profits tax returns should be filed.

## DOUBLE TAXATION

A taxpayer could be subject to both Hong Kong tax and overseas tax. The IRO provides that Hong Kong may make arrangement with other territories to afford relief from double taxation when the other jurisdiction imposes a tax similar in nature to a Hong Kong tax.

To prevent the double taxation of income between Hong Kong and the PRC, a comprehensive double taxation arrangement was signed between the two parties in August 2006. Such arrangement covers profits tax, salaries tax and property tax, whether or not the tax is charged under personal assessment, in Hong Kong; and individual income tax and enterprise income tax in the PRC.

In addition, comprehensive double tax agreements have been concluded by Hong Kong with various other countries. A complete list of the agreements with the respective dates of signature and the coming into effect are set out as follows.

<b>Country / Territory</b>	<b>Date of signature of agreement</b>	<b>Effective (Year of Assessment)</b>
Austria	25.05.2010	2012/2013
Belarus	16.01.2017	Pending
Belgium	10.12.2003	2004/2005
Brunei	20.03.2010	2011/2012
Canada	11.11.2012	2014/2015
Czech	06.06.2011	2013/2014
France	21.10.2010	2012/2013
Guernsey	22.04.2013	2014/2015
Hungary	12.05.2010	2012/2013
Indonesia	23.03.2010	2013/2014
Ireland	22.06.2010	2012/2013
Japan	09.11.2010	2012/2013
Jersey	22.02.2012	2014/2015
Korea	08.07.2014	2017/2018
Kuwait	13.05.2010	2014/2015
Latvia	13.04.2016	Pending
Liechtenstein	12.08.2010	2012/2013
Luxembourg	02.11.2007	2008/2009
PRC	21.08.2006	2007/2008
Malaysia	25.04.2012	2013/2014
Malta	08.11.2011	2013/2014
Mexico	18.06.2012	2014/2015
Netherlands	22.03.2010	2012/2013
New Zealand	01.12.2010	2012/2013
Pakistan	17.02.2017	Pending
Portugal	22.03.2011	2013/2014
Qatar	13.05.2013	2014/2015
Romania	18.11.2015	0.01.2017
Russia	18.01.2016	2017/2018
Saudi Arabia	24.08.2017	Pending
South Africa	16.10.2014	2016/2017
Spain	01.04.2011	2013/2014
Switzerland	04.10.2011	2013/2014
Thailand	07.09.2005	2006/2007
United Arab Emirates	11.12.2014	2016/2017
United Kingdom	21.06.2010	2011/2012
Vietnam	16.12.2008	2010/2011

## STAMP DUTY

Stamp duty is chargeable on the documents set out in the First Schedule to the Stamp Duty Ordinance (Cap. 117) which imposes fixed duty on some documents and an ad valorem duty on others. On 22 February 2013, the Financial Secretary announced that the Government would amend the Stamp Duty Ordinance to adjust the ad valorem stamp duty (“AVD”) rates and to advance the charging of AVD on non-residential property transactions from the conveyance on sale to the agreement for sale. Any residential property (except that acquired by a Hong Kong Permanent Resident who does not own any other residential property in Hong Kong at the time of acquisition) and non-residential property acquired on or after 23 February 2013, either by an individual or a company, will be subject to the new rates of AVD upon the enactment of the relevant legislation. Transactions which took place before 23 February 2013 will be subject to the original stamp duty regime. The new rates of AVD are calculated at rates which vary with the amount/value of the consideration or value of the property as follows.

Amount or value of the consideration or value of the property (in HK\$)		Rate (with effect from 22 February 2013)
Exceeds	Does not exceed	1.5%
\$2,000,000	\$2,000,000	HK\$30,000/100 + 20% of excess over HK\$2,000,000
\$2,176,470	\$2,176,470	3%
\$3,000,000	\$3,000,000	HK\$90,000 + 20% of excess over HK\$3,000,000
\$3,290,330	\$3,290,330	4.5%
\$4,000,000	\$4,000,000	HK\$180,000 + 20% of excess over HK\$4,000,000
\$4,428,580	\$4,428,580	6%
\$6,000,000	\$6,000,000	HK\$360,000 + 20% of excess over HK\$6,000,000
\$6,720,000	\$6,720,000	7.5%
\$20,000,000	\$20,000,000	HK\$1,500,000 + 20% of excess over HK\$20,000,000
\$21,739,130	\$21,739,130	8.5%

On 26 October 2012, the Government amended the Stamp Duty Ordinance to introduce with effect from 27 October 2012 a Buyer’s Stamp Duty (“BSD”) on residential properties. Any residential property acquired by any person (including a company incorporated) except a Hong Kong Permanent Resident will be subject to the BSD. BSD is to be charged at a flat rate of 15% on all residential properties, on top of the existing stamp duty and the special stamp duty, if applicable.

For residential property acquired on or after 20 November 2010 and disposed within 24 months, Special Stamp Duty (“SSD”) will be imposed in addition to the ad valorem duty. The amount of SSD is calculated by reference to the stated consideration or the market value of the property (whichever is higher) at the following regressive rates for different holding periods by the transferor before the disposal:



<b>Holding Period</b>	<b>Rate</b>
6 months or less	15%
More than 6 months but for 12 months or less	10%
More than 12 months but for 24 months or less	5%

Leases granted in consideration of premium only attract the same duties as for conveyances of land. For leases granted in consideration of both premium and rent, the premium attracts an ad valorem duty of 4.25% while the rate of duty on rents varies with the period of the lease (from 0.25% to 1% of the annual rent).

Transactions in Hong Kong stock require the preparation of contract notes on which buyers and sellers have each to pay ad valorem duty at the rate of 0.1% of the consideration.

In all cases, the Collector of Stamp Revenue is empowered to charge duty based on the market value of the property conveyed or shares transferred if he is of the opinion that the consideration is inadequate.

#### **EVASION OF TAX**

All tax returns contain a declaration to the effect that the information returned therein is true, correct and complete. Understatement or omission of profits or income or the submission of false information constitutes an offence.

Submission of an incorrect tax return without reasonable excuse is an offence subject to a fine of HK\$10,000 and a further fine of treble the amount of tax which has been undercharged and imprisonment of 6 months. The imposition of a penalty may, however, be dealt with administratively by the Commissioner of Inland Revenue.

The wilful submission of an incorrect tax return with intent to evade tax is a serious offence. On conviction, the maximum penalty is a fine of HK\$50,000 plus a further fine of treble the amount of tax undercharged and imprisonment for 3 years.

#### **ADVANCE RULINGS**

Subject to payments and certain regulations, a person may apply to the Commissioner of Inland Revenue for a ruling on how any provision of the IRO applies to him or the arrangement specified in the application.

# Hong Kong | FOREIGN INVESTMENT

## HONG KONG'S FOREIGN INVESTMENT CLIMATE

The Hong Kong Special Administrative Region (“HKSAR” or “Hong Kong”) is receptive to foreign investment and does not discriminate between foreign and domestic investors. Attracting foreign investment is a priority of the government and is widely considered beneficial, even crucial, for Hong Kong’s economic stability. It is quite common to have 100 per cent foreign investment in certain industries.

Hong Kong’s predictable business environment, rule of law, stable and low tax regime, free flow of information and capital, good infrastructure and proximity to the People’s Republic of China (“PRC”) make it a desirable platform for investors. Hong Kong was named number one in the 2017 Index of Economic Freedom, compiled by The Heritage Foundation and The Wall Street Journal with a score of 89.8.

Foreign direct investment flows into Hong Kong exceeded US\$108 billion in 2016. Hong Kong currently ranks fourth globally in terms of foreign direct investment inflows, after the United States, the United Kingdom and the PRC, and was second only to the PRC in Asia.

## HONG KONG BASIC LAW REGARDING FOREIGN INVESTMENT

The Basic Law of the HKSAR has provisions safeguarding Hong Kong’s free enterprise system and liberal investment regime.

Among other things, the Basic Law upholds the principles of a low tax policy, free convertibility of the Hong Kong dollar and free flow of capital.

## BUSINESS ENTITIES AVAILABLE TO FOREIGN INVESTORS

- 1. Types of business structures:** no distinction is made between foreign and domestic investors in terms of the types of business structures that may be used to carry on business in Hong Kong. Foreign investors may make use of all available forms of Hong Kong business entities.

Overseas companies that intend to establish an office in Hong Kong that do not wish to create a Hong Kong-incorporated subsidiary may register as non-Hong Kong companies under Part 16 of the Companies Ordinance (Cap. 622) (the “Companies Ordinance”). Hong Kong registered foreign corporations, with the exception of certain provisions, are not governed by the provisions of the Companies Ordinance. While the Companies Ordinance governs the formation and dissolution of Hong Kong companies, the creation and dissolution of a foreign corporation are governed by the law of its place of incorporation.

Within one month after establishing a place of business in Hong Kong, an overseas incorporated company must register as a non-Hong Kong company under Part 16 of the Companies Ordinance by registering certain documents with the Registrar of Companies and must obtain a business registration certificate from the Inland Revenue Department.

A non-Hong Kong company registered under Part 16 of the Companies Ordinance must report to the Registrar of Companies any subsequent changes to its name, directors, secretaries, authorised representatives, memorandum and articles of association, the address of its principal place of business and registered office, each within one month of the change by submitting the prescribed forms. The creation of a charge on property situated in Hong Kong and any existing charge on acquired property situated in Hong Kong must be registered with the Registrar of Companies. Every year, a non-Hong Kong company must submit to the Registrar of Companies an annual return and a copy of its annual accounts (if applicable). Such obligations will cease if the company ceases to have a place of business in Hong Kong.

- 2. Directors:** under the Companies Ordinance, a director can be of any nationality as long as he has attained the age of 18 and has not been disqualified from acting as a director. He can also be resident in Hong Kong or overseas. Therefore, he does not have to reside in Hong Kong when he is acting as a director. When a company appoints a director, the company must send a specific form to the Registrar of Companies of such appointment setting out the director's name and usual residential address and the number of his identity card or passport, and including a statement signed by the director that he accepts the appointment and has attained 18 years of age.

Directors of companies owe a number of duties, which are based on the principle of showing the utmost good faith toward the company. Generally, directors' duties are owed only to the company itself; directors have been held to owe fiduciary duties to individual shareholders only in limited circumstances. Fiduciary duties of directors, which are generally based on equitable principles, mainly include:

- A duty to act in good faith in the interests of the company
- A duty to avoid actual or potential conflicts of duty and interest
- A duty to exercise powers for a proper purpose for the benefit of members as a whole

Directors also owe a duty of reasonable care, skill and diligence to the company, which is codified in the Companies Ordinance. The Companies Ordinance requires a director to exercise reasonable care, skill and diligence, meaning the care, skill and diligence that would be exercised by a reasonably diligent person with:

- The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (an objective test)
- The general knowledge, skill and experience that the director has (a subjective test)

In addition to the general duties listed above, "A Guide on Directors' Duties" issued by the Companies Registry also includes the following general directors' duties:

- A duty not to delegate powers except with proper authorisation and a duty to exercise independent judgement
- A duty to exercise care, skill and diligence
- A duty not to gain advantage from the use of a position as a director
- A duty not to make unauthorised use of a company's property or information
- A duty not to accept personal benefit from third parties conferred because of a position as a director
- A duty to observe the company's constitution and resolutions
- A duty to keep proper accounting records

Directors of companies listed on the Stock Exchange of Hong Kong Limited (the "Exchange") must also comply with their duties and obligations as directors of a listed company under the Exchange's Listing Rules and the Corporate Governance Code in Appendix 14 of the Listing Rules. Directors who breach their duties and obligations as a director may be liable to civil or criminal proceedings and may be disqualified from acting as a director.

## FOREIGN INVESTMENT INCENTIVES

There are no specially enacted incentives for foreign investment. However, all foreign companies benefit from the Hong Kong government's policy of providing an appealing climate for investment. It promotes fair competition and does not discriminate between foreign and domestic investors.

Hong Kong generally has lower rates of tax than most other Asian jurisdictions and its tax environment is relatively simple. In particular, there is:

- No tax on capital gains
- No tax on profits arising in or derived from outside Hong Kong
- No tax on dividends
- No estate duty

There are three separate direct taxes which are levied under the Inland Revenue Ordinance (Cap. 112) (the "IRO"). The three taxes are: profits tax, salaries tax and property tax. The ambit of the IRO is limited territorially and it is only income with a Hong Kong source which, by and large, is subject to tax.

1. **Profits tax:** persons, including corporations, partnerships, trustees and bodies of persons carrying on any trade, profession or business in Hong Kong are chargeable to profits tax on the assessable profits arising in or derived from Hong Kong from such trade, profession or business. No distinction is made between residents and non-residents. A resident may therefore derive profits from abroad without being subject to tax; conversely, a non-resident may be chargeable to tax on profits arising in or derived from Hong Kong. Whether a business is carried on in Hong Kong and whether profits are derived from Hong Kong are largely questions of fact. However, some guidance on the principles applied can be found in cases which have been considered by the courts in Hong Kong and in other common law jurisdictions.
2. **Tax rates:** the tax rate for profits tax is 16.5% for corporations and 15% for unincorporated businesses.
3. **Tax incentives and allowances:** in terms of tax incentives and allowances available in Hong Kong, no distinction is made between residents and non-residents. Foreign investors may make use of all types of tax incentives and tax allowances available in Hong Kong.

**The tax incentives include (but are not limited to):**

- Immediate writing-off is allowed for capital expenditure on plant and machinery specifically and directly related to manufacturing processes, and on computer hardware and software
- Capital expenditure on refurbishment of business premises is allowed to be written off over five years of assessment
- There is an exemption from payment of tax on interest derived from any deposit placed in Hong Kong with an authorised institution (but this is not applicable to interest received by or accrued to a financial institution)
- Accelerated deduction for capital expenditure on specified environmental protection facilities from year of assessment 2008/09 onwards. For machinery or plant, 100% deduction will be allowed for the capital expenditure incurred. For installations forming part of a building or structure, 20% deduction will be allowed for each year in five consecutive years
- 100% deduction for capital expenditure on specified environmental-friendly vehicles from year of assessment 2010/11 and onwards

**Generally, all outgoings and expenses are deductible to the extent that they have been incurred in the production of chargeable profits. They include (but are not limited to):**

- Rent paid by any tenant of buildings or land occupied for the purpose of producing the assessable profits
- Bad and doubtful debts (subject to certain rules)
- Repairs of premises, plant, machinery, implements, utensils or articles used in producing profits (other than the cost of improvements)
- Expenditure for registration of a trademark, design or patent and expenditure on the purchase of patent rights or rights to any know-how for use in Hong Kong in the production of assessable profits
- Expenditure on research and development (subject to certain rules)
- Donations of an aggregate of not less than HK\$100 made to approved charities with the restriction that such donation shall not exceed 35% from year of assessment 2008/09 onwards of the adjusted assessable profits

## FOREIGN INVESTMENT RESTRICTIONS

As previously discussed, Hong Kong does not generally subject foreign investments to special regulatory regimes or requirements.

However, there are restrictions in certain areas. For example, there are restrictions on voting control by non-Hong Kong residents and corporations in the broadcasting sector. The Hong Kong government considers that such restrictions are justified as the media has an extensive reach and the potential to influence a large proportion of the population.

- 1. Television broadcasting restrictions:** pursuant to the Broadcasting Ordinance (Cap.562) (the "BO"), an 'unqualified voting controller' (that is, a person who alone or with others, directly or indirectly, has the ability to control the exercise of the right to vote, who has not been ordinarily resident in Hong Kong for a period of seven years) is prohibited from holding or acquiring specified thresholds in aggregate of the total voting control of a domestic free television programme service licensee without the prior written consent of the Broadcasting Authority.

There are no equivalent restrictions on voting control by non-residents for domestic pay television programme service licensees or non-domestic television programme service licensees.

- 2. Sound broadcasting restrictions:** pursuant to the Telecommunications Ordinance (Cap. 106) (the "TO"), the aggregate of the voting shares in a sound broadcasting licensee in which 'unqualified persons' (that is, persons not ordinarily resident in Hong Kong for seven years) have, directly or indirectly, any right, title or interest, must not exceed 49 per cent of the total number of voting shares in the licensee. Under the TO, a licence will only be granted to or held by a "corporation that is:
- A company formed and registered in Hong Kong under the Companies Ordinance
  - Not a subsidiary
  - Empowered under its articles of association to comply fully with the provisions of the TO and the terms and conditions of its licence."

## INVESTMENT AS ENTREPRENEUR

Hong Kong maintains an Investment as Entrepreneur visa scheme to facilitate the entry for residence by persons who want to establish or join a business in Hong Kong, and are in a position to make a substantial contribution to Hong Kong's economy.

Applicants are required to (i) have a good education background, as well as proven professional abilities and/or relevant experience and achievements, (ii) have no record of serious crime, and (iii) be in a position to make a substantial contribution to Hong Kong's economy.

The Hong Kong authorities consider several factors in determining economic contribution, including but not limited to, a two-year business plan, business turnover, financial resources, investment sum, number of jobs created locally and the introduction of new technology or skills. The Hong Kong Immigration Department requires detailed documentation to support these factors.

Notably, there are no prescribed minimum investment requirements.

An essential requirement is that the applicant be supported by a local sponsor, which may be an individual or a company. Individuals who are sponsors must be over 18, a bona fide Hong Kong resident and acquainted with the applicant.

#### **EXCHANGE CONTROLS**

There are no restrictions on foreign exchange transactions, capital movement or repatriation of funds, nor special approval or notification requirements for foreign investments in Hong Kong.

# Hong Kong | LABOUR LAW

## HONG KONG EMPLOYMENT LAW FRAMEWORK

Employment law in Hong Kong is derived from local legislation and the common law.

- 1. Legislation:** the Employment Ordinance (Cap. 57) is the main piece of legislation governing employment in Hong Kong. All employees covered by the Employment Ordinance, irrespective of their hours of work, are entitled to basic protection under the Employment Ordinance. Parties may not contract out of the Employment Ordinance provisions and any agreement attempting to do so is void.

The Minimum Wage Ordinance (Cap. 608) establishes a statutory minimum wage regime aimed at striking a balance between preventing excessively low wages and minimising the loss of low-paid jobs, while sustaining Hong Kong's economic growth and competitiveness.

The Employees' Compensation Ordinance (Cap. 282) establishes a no-fault, non-contributory employee compensation system for work injuries. Every employer must obtain an insurance policy in respect of its liability to compensate employees for work injuries.

The Mandatory Provident Fund Schemes Ordinance (Cap. 485) was launched in 2000 to provide retirement protection to the entire workforce in Hong Kong.

There are also certain anti-discrimination laws in force in Hong Kong to prohibit discrimination on grounds such as sex, pregnancy, marital status, disability, family status and race.

- 2. Common Law:** case law is used to interpret employment law legislation, explain and expand the tests and definitions and fill the gaps using common law principles. Whilst Hong Kong cases are binding on Hong Kong courts, case law from other common law jurisdictions may be considered and have persuasive authority in Hong Kong.

## EMPLOYMENT ORDINANCE

- 1. Application of the Employment Ordinance /** Applies to all employees with the following exceptions:

- A family member who lives in the same dwelling as the employer
- An employee as defined in the Contracts for Employment Outside Hong Kong Ordinance (Cap. 78)
- A person serving under a crew agreement under the Merchant Shipping (Seafarers) Ordinance (Cap. 478), or on board a ship which is not registered in Hong Kong
- An apprentice whose contract of apprenticeship has been registered under the Apprenticeship Ordinance (Cap. 47), except with respect to certain provisions in that Ordinance.

All employees covered by the Employment Ordinance, irrespective of their hours of work, are entitled to basic protection under the Employment Ordinance including payment of wages, restrictions on deductions from wages and the granting of statutory holidays, etc.

Employees who are employed under a continuous contract are further entitled to benefits such as rest days, paid annual leave, sickness allowance, severance payment and long service payment.



## 2. Contract of Employment

A contract of employment is an agreement concerning employment conditions made between an employer and an employee. Employers and employees are free to negotiate and agree on the terms and conditions of employment provided that they do not violate the provisions of the Employment Ordinance. Any term of an employment contract which purports to extinguish or reduce any right, benefit or protection conferred upon the employee by the Employment Ordinance is void. Therefore, the Employment Ordinance will prevail if any contractual terms are less favourable than those provided for in the Ordinance.

### ► Information on Conditions of Service

Before employment begins, an employer must clearly inform each employee of the conditions of employment under which he is to be employed with regard to:

- Wages (see definition below)
- Wage period
- Length of notice required to terminate the contract
- If the employee is entitled to an end of year payment, the end of year payment or proportion and the payment period

Whenever there is any change in the conditions of service, whether these have merely been proposed to an employee or are actually in force, the employer shall inform him in an intelligible manner.

## 3. Wages

"Wages" means all remuneration, earnings, allowances (including travelling allowances and attendance allowances), attendance bonus, commission, overtime pay, tips and service charges payable to an employee in respect of work done or work to be done. However, wages do not include certain items such as accommodation or education provided by the employer, the employer's contribution to any retirement scheme, non-recurrent travel allowance, and commission or annual bonus which is of a gratuitous nature or paid only at the discretion of the employer.

### ► Minimum Wage Ordinance

The Minimum Wage Ordinance provides a wage floor to protect grass-roots employees. It came into effect on 1 May 2011 and the current statutory minimum wage rate ("SMW rate") is HK\$34.50 per hour. In essence, wages payable to an employee in respect of any wage period, when averaged over the total number of hours worked in the wage period, should be no less than the SMW rate.

- **Application of the Minimum Wage Ordinance SMW** - applies to all employees, whether they are monthly-rated, weekly-rated, daily-rated, hourly-rated, piece-rated, permanent, casual, full-time, part-time or other employees, and regardless of whether or not they are employed

under a continuous contract as defined in the Employment Ordinance, except for (i) persons to whom the Employment Ordinance does not apply; (ii) live-in domestic workers; (iii) student interns undergoing a period of work arranged or endorsed by a specified education institution or an institution in connection with a non-local education institution; and (iv) work experience students where the contract is for a continuous period of up to 59 days, provided that the student was not a party to another contract of work experience during the same calendar year.

- **Amount of minimum wage** - wages payable to an employee in respect of any wage period must not be less than the amount of minimum wage calculated as follows:

$$\text{Minimum wage} = \frac{\text{Total number of hours worked by the employee in the wage period}}{\text{SMW rate (i.e. \$34.50)}} \times$$

#### 4. Rest Days, Holidays and Leave

An employee must be allowed to enjoy rest days, statutory holidays and paid annual leave during employment.

##### ▶ Rest Days and Statutory Holiday

An employee employed under a continuous contract is entitled to at least one rest day in every seven days. While an employee may work voluntarily on a rest day, an employer must not compel an employee to work on a rest day except in cases of unforeseen emergency.

An employer is required to grant an employee a statutory holiday, or arrange an "alternative holiday" or "substituted holiday". "Buy-out" of a holiday, i.e. payment in lieu of granting a holiday, is not allowed.

##### ▶ Paid Annual Leave

An employee is entitled to annual leave with pay after having been employed under a continuous contract for 12 months. An employee's entitlement to paid annual leave increases progressively from seven days to a maximum of 14 days according to the length of service.

#### 5. Sickness and Maternity Protection

##### ▶ Paid Annual Leave

An employee employed under a continuous contract for a period of at least one month is entitled to sickness allowance. An employer is prohibited from terminating the employment contract of an employee on his paid sickness day, except in cases of summary dismissal due to the employee's serious misconduct.

##### ▶ Maternity Leave

A female employee under a continuous contract, subject to certain qualifying requirements under the Employment Ordinance, is entitled to a continuous period of 10 weeks' paid maternity leave.

An employer is prohibited from dismissing a pregnant employee from the date on which she is confirmed to be pregnant by a medical certificate to the date on which she is due to return to work upon the expiry of her maternity leave.

**6. End of Year Payment**

The provisions concerning end of year payment apply to an employee employed under a continuous contract who, in accordance with a term of his contract is entitled to an end of year payment from his employer.

Such end of year payment means any annual payment (including double pay, 13th month payment, end of year bonus) of a contractual nature. It does not include any payment which is of a gratuitous nature or which is payable at the discretion of the employer.

**7. Termination of Contract of Employment**

► **Termination of Employment Contract by Notice or Payment in lieu of Notice**

A contract of employment may be terminated by the employer or employee through giving the other party due notice or wages in lieu of notice. In the case of a continuous contract of employment, the length of notice or the amount of wages in lieu of notice required are:

**Table 1**

Employment Condition		Length of notice	Wages in lieu of notice
During Probation Period	Within the first month of probation	Not required	Not required
	After the first month of probation	Within the first month of probation	Table 2
		Without agreement to the length of notice	Not less than 7 days
No/after probation period	With agreement to the length of notice	As per agreement, but not less than 7 days	Table 2
	With agreement to the length of notice	Not less than 1 month	Table 2

**Table 2**

<b>Notice period expressed in days or weeks</b>	Average daily wages earned by an employee in the 12-month period preceding the day when a notice of termination of contract is given	×	Number of days in the notice period for which wages would normally be payable to the employee	=	Wages in lieu of notice
<b>Notice period expressed in months</b>	Average monthly wages earned by an employee in the 12-month period preceding the day when a notice of termination of contact is given	×	Number of months specified in the notice period	=	Wages in lieu of notice

► **Termination of Employment Contract Without Notice or Wages in lieu of Notice**

An employer may summarily dismiss an employee without notice or payment in lieu of notice if the employee, in relation to his employment: (i) wilfully disobeys a lawful and reasonable order; (ii) is guilty of misconduct; (iii) is guilty of fraud or dishonesty; or (iv) is habitually neglectful in his duties.

Taking part in a strike is not a lawful ground for an employer to terminate an employee's contract of employment without notice or payment in lieu.

*Summary dismissal is a serious disciplinary action. It only applies to cases where an employee has committed very serious misconduct or fails to improve after the employer's repeated warnings.*

An employee may terminate his employment contract without notice or payment in lieu of notice if: (i) he reasonably fears physical danger by violence or disease; (ii) he is subjected to ill-treatment by the employer; or (iii) he has been employed for not less than five years and is certified by a registered medical practitioner or a registered Chinese medicine practitioner as being permanently unfit for the type of work he is engaged to perform.

► **Statutory Restrictions on Termination of Employment Contract**

An employer may not dismiss an employee under the following circumstances:

- **Maternity Protection** - an employer may not dismiss a female employee who has been confirmed to be pregnant and has served a notice of pregnancy.
- **Paid Sick Leave** - an employer may not dismiss an employee whilst the employee is on paid sick leave.
- **Giving evidence or information to the authorities** - an employer may not dismiss an employee by reason of his giving evidence or information in any proceedings or inquiry in connection with the enforcement of the Employment Ordinance, work accidents or breach of work safety legislation.
- **Trade Union Activities** - an employer may not dismiss an employee for trade union membership and activities.
- **Injury at Work** - an employer may not dismiss an injured employee before having entered into an agreement with the employee for the employee's compensation or before the issue of a certificate of assessment.

► **Termination Payments**

The items and amount of payments payable to an employee on termination of employment or expiry of the contract depend on a number of factors such as the length of service, the terms of the employment contract and the reason for termination of the contract. Termination payments usually include:

- Outstanding wages;
- Wages in lieu of notice, if any;
- Payment in lieu of any untaken annual leave, and any pro rata annual leave pay for the current leave year; Any outstanding sum of end of year payment (where applicable);
- Where appropriate, long service payment or severance payment; and
- Other payments under the employment contract, such as, gratuity, provident fund, etc.

## 8. Employment Protection

The section of the Employment Ordinance on Employment Protection aims to discourage employers from dismissing, or varying the contractual employment terms of, their employees in order to evade their liabilities under the Employment Ordinance.

### ► Eligibility and Remedies for Employment Protection

An employee may claim for remedies against an employer in the following situations:

Situations	Conditions	Remedies
Unreasonable Dismissal	The employee has been employed under a continuous contract for a period of not less than 24 months; and	An order for reinstatement or re-engagement; or
	The employee is dismissed other than for a valid reason as specified in the Ordinance	An award of terminal payments
Unreasonable Variation of the Terms of the Employment Contract	The employee has been employed under a continuous contract;	An order for reinstatement or re-engagement; or
	The terms of the employment contract are varied without the employee's consent;	An award of terminal payments
	The employment contract does not contain an express term which allows such a variation; and The terms of the employment contract are varied other than for a valid reason as specified in the Ordinance	
Unreasonable and Unlawful Dismissal	The employee is dismissed other than for a valid reason as specified in the Ordinance; and	An order for reinstatement or re-engagement; or
	The dismissal is in contravention of the law	An award of terminal payments; and/or An award of compensation not exceeding HK\$150,000

### ► Valid Reasons for Dismissal or Variation of the Terms of an Employment Contract

The five valid reasons for dismissal or variation of the terms of an employment contract are:

- The conduct of the employee
- The capability or qualifications of the employee for performing his work
- Redundancy or other genuine operational requirements of the business
- Statutory requirements (i.e. it would be contrary to the law to allow an employee to continue to work in his original position or to continue with the original terms of his employment contract)
- Other substantial reasons

### ► Remedies for Employment Protection

Remedies for Employment Protection, which are awarded by the Labour Tribunal, include an order of reinstatement or re-engagement, an award of terminal payments and an award of compensation.

**9. Severance Payment and Long Service Payment**

► **Eligibility for Severance Payment and Long Service Payment**

An employee is eligible for severance payment or long service payment subject to the following conditions

Entitlement	Severance Payment	Long Service Payment
Qualifying period of employment	Not less than 24 months under a continuous contract	Not less than 5 years under a continuous contract
Qualifying period of employment	The employee is dismissed by reason of redundancy*	The employee is dismissed but: <ul style="list-style-type: none"> <li>• He is not summarily dismissed due to his serious misconduct;</li> <li>• His dismissal is not by reason of redundancy</li> </ul>
	Employment contract of a fixed term expires without being renewed by reason of redundancy	Employment contract of a fixed term expires without being renewed*
	The employee is laid off	The employee dies
		The employee resigns on ground of ill health
		The employee, aged 65 or above, resigns on ground of old age

\* An employee will not be simultaneously entitled to both long service payment and severance payment.

**MEANING OF REDUNDANCY**

An employee is taken to be dismissed by reason of redundancy if the dismissal is due to the fact that: (i) the employer closes his business; (ii) the employer has ceased the business in the place where the employee was employed; or (iii) the requirement of the business for employees to carry out work of a particular kind ceases or diminishes.

**MEANING OF LAY-OFF**

If an employee is employed on such terms and conditions that his remuneration depends on his being provided by the employer with work of the kind he is employed to do, he will be taken to be laid-off if the total number of days on which no work is provided or no wages are paid exceeds: (i) half of the total number of normal working days in any four consecutive weeks; or (ii) one-third of the total number of normal working days in any 26 consecutive weeks.

► **Amount of Severance Payment/ Long Service Payment**

The following formula applies to the calculation of both severance payment and long service payment:

<b>Monthly-paid employee</b>	Last month wages x 2/3	×	Reckonable years of service
<b>Daily-rated/piece-rate employee</b>	Any 18 days' wages chosen by the employee out of his last 30 normal service working days	×	Reckonable years of service

**10. Protection Against Anti-Union Discrimination**

► **Right of an Employee to Participate in Trade Unions**

Every employee has the right to be a member or an officer of a trade union and to take part in the activities of the trade union.

An employer must not prevent or deter an employee from exercising any of the above rights and must not dismiss, penalise or discriminate against an employee for exercising such rights.

**EMPLOYMENT ORDINANCE**

**1. Application of the Employees' Compensation Ordinance**

The Employees' Compensation Ordinance applies to all full-time or part-time employees who are employed under contracts of service or apprenticeship, including domestic helpers, agricultural employees, crew members of a Hong Kong ship, and any person employed in any capacity on board of a Hong Kong ship.

The Employees' Compensation Ordinance also applies to employees employed in Hong Kong by local employers injured while working outside Hong Kong. Even if the employer is a person carrying on business outside Hong Kong, or the employee is a crew member of a foreign ship, the Employees' Compensation Ordinance still applies if the employer submits to the jurisdiction of the courts of Hong Kong.

The Employees' Compensation Ordinance does not however apply to casual employees, outworkers or members of the employer's family who live with him.

**2. Statutory Liability of the Employer**

► **Injury by Accident**

If an employee sustains an injury or dies as a result of an accident arising out of and in the course of his employment, his employer is generally liable to pay compensation under the Employees' Compensation Ordinance.

► **Occupational Disease**

An employee suffering incapacity arising from an occupational disease as defined in the Employees' Compensation Ordinance is entitled to receive the same compensation as that payable to an employee injured in an accident arising out of and in the course of employment, subject to certain qualifying requirements.

Where an employee suffers from a disease outside the scope of the Employees' Compensation Ordinance, he/she may still claim compensation thereunder if the disease is certified to be a personal injury by accident arising out of and in the course of employment.

**3. Compulsory Insurance**

The Employees' Compensation Ordinance obliges an employer to obtain a policy of insurance to cover its liabilities both under the Employees' Compensation Ordinance and at common law for injuries at work in respect of all its employees.

N° of Employees	Amount of Insurance Cover per Event
Not more than 200	Not less than \$100 million
More than 200	Not less than \$200 million

**4. Claims for Damages by Action at Common Law**

N° of Employees	Amount of Insurance Cover per Event
<p><b>By an employee</b> - when an employee is injured in circumstances which created legal liability in some person other than the employer, he may take proceedings to recover damages from the third party, as well as claiming compensation against the employer.</p> <p><b>By an employer</b> - Similarly, an employer who is liable to pay compensation may take action against a third party to recover the compensation, indemnity or any sum payable to the employee contractually.</p>	<p>The Ordinance does not limit the civil liability of an employer. Thus, when an injury to an employee is caused by the negligence or other wrongful act of an employer, the employee may recover compensation and also sue for damages, but the damages awarded will be reduced by the value of the compensation paid or payable under the Ordinance.</p>

**MANDATORY PROVIDENT FUND SCHEMES ORDINANCE**

To provide retirement protection to the entire workforce in Hong Kong, a mandatory provident fund ("MPF") system was introduced under the Mandatory Provident Fund ("MPF") Schemes Ordinance in 2000. It requires both employees (with the exception of certain exempt persons) and employers to make regular contributions into a registered MPF scheme. Every employer is obliged to contribute an amount equal to at least 5% of an employee's salary (subject to the maximum level of income, currently set at HK\$25,000 per month) to such MPF scheme. Every employee is also required to contribute at least 5% of his/her salary to the scheme, also subject to the same maximum level of income.

A number of employers had been operating voluntary retirement schemes regulated under the Occupational Retirement Schemes Ordinance (Cap 426) ("ORSO") before the introduction of the MPF scheme. Many such voluntary ORSO schemes obtained MPF exemption and continue to operate. Members of an MPF-exempted ORSO scheme, as well as new employees eligible to join an MPF-exempted ORSO scheme after the commencement of the MPF system, have a one-off option to choose between the ORSO scheme and an MPF scheme.

**ANTI-DISCRIMINATION LEGISLATION**

There are certain anti-discrimination laws in force in Hong Kong: the Sex Discrimination Ordinance (Cap. 480), the Disability Discrimination Ordinance (Cap. 487), the Family Status Discrimination Ordinance (Cap. 527) and the Race Discrimination Ordinance (Cap. 282) which prohibit discrimination on the basis of sex, pregnancy, marital status, disability, family status and race. There are also provisions in the Employment Ordinance guarding against discrimination on the ground of trade union membership.







# Indconlegal

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India

📍 K 1/125, LGF Chitranjan Park,  
New Delhi, Delhi 110019, India

☎ +91 9313353317

[lalitmath@indconlegal.in](mailto:lalitmath@indconlegal.in)

[www.indconlegal.com](http://www.indconlegal.com)

# India | FOREIGN INVESTMENT

## INDIA MARKET SIZE

The total FDI investments India received during April-June 2017 stood at US\$ 14.55 billion, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results. Data for April-June 2017 indicates that the services sector attracted the highest FDI equity inflow of US\$ 1.88 billion, followed by computer software and hardware – US\$ 1.32 billion and trading – US\$ 769 million. Most recently, the total FDI equity inflows for the month of June 2017 touched US\$ 3.12 billion.

During April-June 2017, India received the maximum FDI equity inflows from Mauritius (US\$ 3.29 billion), followed by Singapore (US\$ 3.01 billion), Germany (US\$ 798 million), USA (US\$ 660 million), and Netherlands (US\$ 584 million).

Indian impact investments may grow 25 per cent annually to US\$ 40 billion from US\$ 4 billion by 2025.

## INDIAN COMPANIES ACT

The Indian Companies Act, 2013 replaced the old Indian Companies Act, 1956. The Companies Act, 2013 makes comprehensive provisions to govern all listed and unlisted companies in the country. The Companies Act, 2013 implemented many new sections and repealed the relevant corresponding sections of the Companies Act, 1956. This is a landmark legislation with far-reaching consequences on all companies incorporated in India.

## SALIENT FEATURES OF THE COMPANIES ACT, 2013

- 1. Class action suits for Shareholders:** The Companies Act, 2013 has introduced new concept of class action suits with a view of making shareholders and other stakeholders, more informed and knowledgeable about their rights
- 2. More power for Shareholders:** The Companies Act, 2013 provides for approvals from shareholders on various significant transactions
- 3. Women empowerment in the corporate sector:** The Companies Act, 2013 stipulates appointment of at least one woman Director on the Board (for certain class of companies).
- 4. Corporate Social Responsibility(CSR):** The Companies Act, 2013 stipulates certain class of Companies to spend a certain amount of money every year on activities/initiatives reflecting Corporate Social Responsibility.
- 5. National Company Law Tribunal(NCLT):** The Companies Act, 2013 introduced National Company Law Tribunal and the National Company Law Appellate Tribunal to replace the Company Law Board and Board for Industrial and Financial Reconstruction. They would relieve the Courts of their burden while simultaneously providing specialized justice.

1. **Fast Track Mergers:** The Companies Act 2013 proposes a fast track and simplified procedure for mergers and amalgamations of certain class of companies such as holding and subsidiary, and small companies after obtaining approval of the Indian government.
2. **Cross Border Mergers:** The Companies Act 2013 permits cross border mergers, both ways; a foreign company merging with an India Company and vice versa but with prior permission of Reserve Bank of India (RBI).
3. **Prohibition on forward dealings and insider trading:** The Companies Act, 2013 prohibits directors and key managerial personnel from purchasing call and put options of shares of the company, if such person is reasonably expected to have access to price-sensitive information.
4. **Increase in number of Shareholders:** The Companies Act, 2013 increased the number of maximum shareholders in a private company from 50 to 200.
5. **Limit on Maximum Partners:** The maximum number of persons/partners in any association/partnership may be upto such number as may be prescribed but not exceeding one hundred. This restriction will not apply to an association or partnership, constituted by professionals like lawyer, chartered accountants, company secretaries, etc. who are governed by their special laws. Under the Companies Act 1956, there was a limit of maximum 20 persons/partners and there was no exemption granted to the professionals.
6. **One Person Company:** The Companies Act, 2013 provides new form of private company, i.e., one person company. It may have only one director and one shareholder. The Companies Act, 1956 required minimum two shareholders and two directors in case of a private company.
7. **Entrenchment in Articles of Association:** The Companies Act, 2013 provides for entrenchment (apply extra legal safeguards) of articles of association have been introduced.
8. **Electronic Mode:** The Companies Act, 2013 proposed E-Governance for various company processes like maintenance and inspection of documents in electronic form, option of keeping of books of accounts in electronic form, financial statements to be placed on company's website, etc.
9. **Indian Resident as Director:** Every company shall have at least one director who has stayed in India for a total period of not less than 182 days in the previous calendar year.
10. **Serving Notice of Board Meeting:** The Companies Act, 2013 requires at least seven days' notice to call a board meeting. The notice may be sent by electronic means to every director at his address registered with the company.
11. **Duties of Director defined:** Under the Companies Act 1956, a director had fiduciary (legal or ethical relationship of trust) duties towards a company. However, the Companies Act, 2013 has defined the duties of a director.
12. **Liability on Directors and Officers:** The Companies Act, 2013 does not restrict an Indian company from indemnifying (compensate for harm or loss) its directors and officers like the Companies Act, 1956.
13. **Rotation of Auditors:** The Companies Act, 2013 provides for rotation of auditors and audit firms in case of publicly traded companies.
14. **Prohibits Auditors from performing Non-Audit Services:** The Companies Act, 2013 prohibits Auditors from performing non-audit services to the company where they are auditor to ensure independence and accountability of auditor.
15. **Independent Directors:** The Companies Act, 2013 provides that all listed companies should have at least one-third of the Board as independent directors. Such other class or classes of public companies as may be prescribed by the Central Government shall also be required to appoint independent directors. No independent director shall hold office for more than two consecutive terms of five years.
16. **Rehabilitation and Liquidation Process:** The entire rehabilitation and liquidation process of the companies in financial crisis has been made time bound under Companies Act, 2013.

## FOREIGN DIRECT INVESTMENT (FDI) IN INDIA

A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited. However, a citizen of Bangladesh or an entity incorporated in Bangladesh can invest only under the Government route. Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.

Non Resident Indians (NRIs), resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the share capital of Indian companies on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.

Foreign Institutional Investor (FII) and Foreign Portfolio Investors (FPI), as the case may be, respectively, invest in the capital of an Indian company under the Portfolio Investment Scheme which limits the individual holding of an FII/FPI below 10% of the capital of the company and the aggregate limit for FII/FPI investment to 24% of the capital of the company. This aggregate limit of 24% can be increased to the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body and subject to prior intimation to RBI. The aggregate FII/FPI investment, individually or in conjunction with other kinds of foreign investment, will not exceed sectoral/statutory cap. Only registered FIIs/FPIs and NRIs can invest/trade through a registered broker in the capital of Indian Companies on recognised Indian Stock Exchanges.

A Securities Exchange Board of India (SEBI) registered Foreign Venture Capital Investor (FVCI) may contribute up to 100% of the capital of an Indian company engaged in any activity including startups irrespective of the sector in which it is engaged, under the automatic route. A SEBI registered FVCI can invest in a domestic venture capital fund registered under the SEBI. Such investments shall also be subject to the extant Foreign Exchange Management Act (FEMA) regulations and extant FDI policy including sectoral caps, etc. The investment can be made in equities or equity linked instruments or debt instruments issued by the company (including start-ups and if a startup is organised as a partnership firm or an LLP, the investment can be made in the capital or through any profit-sharing arrangement) or units issued by a VCF either through purchase by private arrangement either from the issuer of the security or from any other person holding the security or on a recognised stock exchange. It may also set up a domestic asset management company to manage its investments. SEBI registered FVCIs are also allowed to invest under the FDI Scheme, as non-resident entities, in other companies, subject to FDI Policy and FEMA regulations.

## ► Startup Companies

*Start-ups can issue equity or equity linked instruments or debt instruments to FVCI against receipt of foreign remittance, as per the FEMA Regulation. In addition, start-ups can issue convertible notes to person resident outside India subject to the following conditions:*

1. A person resident outside India (other than an individual who is citizen of Pakistan or Bangladesh or an entity which is registered / incorporated in Pakistan or Bangladesh), may purchase convertible notes issued by an Indian startup company for an amount of twenty five lakh rupees or more in a single tranche.
2. A startup company engaged in a sector where foreign investment requires Government approval may issue convertible notes to a non-resident only with approval of the Government.
3. A startup company issuing convertible notes to a person resident outside India shall receive the amount of consideration by inward remittance through banking channels

## ► Entry Routes for Investment

*Investments can be made by non-residents in the equity shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible preference shares of an Indian company, through the Automatic Route or the Government Route. Under the Automatic Route, the non-resident investor or the Indian company does not require any approval from Government of India for the investment. Under the Government Route, prior approval of the Government of India is required. Proposals for foreign investment under Government route, are considered by respective Administrative Ministry/Department.*

*Foreign investment in sectors/activities under government approval route will be subject to government approval where:*

1. An Indian company is being established with foreign investment and is not owned by a resident entity or
2. An Indian company is being established with foreign investment and is not controlled by a resident entity or
3. The control of an existing Indian company, currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens, will be/is being transferred/ passed on to a non-resident entity as a consequence of transfer of shares and/or fresh issue of shares to non-resident entities through amalgamation, merger/demerger, acquisition etc. or
4. The ownership of an existing Indian company, currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens, will be/is being transferred/ passed on to a non-resident entity as a consequence of transfer of shares and/or fresh issue of shares to non-resident entities through amalgamation, merger/demerger, acquisition etc.

## ► Sector Specific Conditions on FDI

### Prohibited Sectors

- a. Lottery Business including Government/private lottery, online lotteries, etc
- b. Gambling and Betting including casinos etc
- c. Chit funds
- d. Nidhi company
- e. Trading in Transferable Development Rights (TDRs)
- f. Real Estate Business or Construction of Farm Houses. 'Real estate business' shall not include development of townships, construction of residential/commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014

- g. Manufacturing of cigars, che-  
roots, cigarillos and cigarettes,  
of tobacco or of tobacco  
substitutes
- h. Activities/sectors not open  
to private sector investment  
e.g.(I) Atomic Energy and (II)  
Railway operations(other than  
permitted activities)

*Foreign technology collaboration in any form including licensing  
for franchise, trademark, brand name, management contract is  
also prohibited for Lottery Business and Gambling and Betting  
activities.*

**Permitted Sectors**

- a. In the following sectors/  
activities, FDI up to the limit  
indicated against each sector/  
activity is allowed, subject to  
applicable laws/regulations;  
security and other conditionali-  
ties. In sectors/activities not lis-  
ted below, FDI is permitted up  
to 100% on the automatic route,  
subject to applicable laws/  
regulations; security and other  
conditionalities. Wherever there  
is a requirement of minimum  
capitalization, it shall include  
share premium received along  
with the face value of the  
share, only when it is received  
by the company upon issue of  
the shares to the non-resident  
investor. Amount paid by the  
transferee during post-issue  
transfer of shares beyond  
the issue price of the share,  
cannot be taken into account  
while calculating minimum  
capitalization requirement
- b. Sectoral cap i.e. the maximum  
amount which can be invested  
by foreign investors in an en-  
tity, unless provided otherwise,  
is composite and includes all  
types of foreign investments,  
direct and indirect
- c. Foreign investment in sectors  
under Government approval  
route resulting in transfer of  
ownership and/or control of  
Indian entities from resident  
Indian citizens to non-resi-  
dent entities will be subject  
to Government approval.  
Foreign investment in sectors  
under automatic route but  
with conditionalities, resulting  
in transfer of ownership and/  
or control of Indian entities  
from resident Indian citizens  
to non-resident entities, will be  
subject to compliance of such  
conditionalities
- d. The sectors which are already  
under 100% automatic route  
and are without conditionalities  
would not be affected
- e. Notwithstanding anything  
contained in paragraphs a) and  
c) above, portfolio investment,  
up to aggregate foreign invest-  
ment level of 49% or sectoral/  
statutory cap, whichever is  
lower, will not be subject to  
either Government approval  
or compliance of sectoral  
conditions, as the case may  
be, if such investment does not  
result in transfer of ownership  
and/or control of Indian entities  
from resident Indian citizens  
to non-resident entities. Other  
foreign investments will be  
subject to conditions of Govern-  
ment approval and complian-  
ce of sectoral conditions as  
laid down in the FDI policy.
- f. Total foreign investment, direct  
and indirect, in an entity will  
not exceed the sectoral/statu-  
tory cap

► **Sector wise FDI Limits**

Sector	FDI Limit	Entry Route & Remarks
Agriculture & Animal Husbandry	100%	Automatic
<ul style="list-style-type: none"> <li>• Floriculture, Horticulture, Apiculture and Cultivation of Vegetables &amp; Mushrooms under controlled conditions.</li> <li>• Development and Production of seeds and planting material.</li> <li>• Animal Husbandry, Pisciculture, Aquaculture.</li> <li>• Services related to agro and allied sectors.</li> </ul>		
Plantation Sector	100%	Automatic
<ul style="list-style-type: none"> <li>• Tea sector including tea plantations.</li> <li>• Coffee plantations.</li> <li>• Rubber plantations.</li> <li>• Cardamom plantations.</li> <li>• Palm oil tree plantations.</li> <li>• Olive oil tree plantations.</li> </ul>		



Sector	FDI Limit	Entry Route & Remarks
Mining	100%	Automatic
<ul style="list-style-type: none"> <li>• Mining and Exploration of metal and non-metal ores including diamond, gold, silver and precious ores but excluding titanium bearing minerals and its ores</li> </ul>		
Mining (Coal & Lignite)	100%	Automatic
Mining	100%	Government
<ul style="list-style-type: none"> <li>• Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities</li> </ul>		
Petroleum & Natural Gas	100%	Automatic
<ul style="list-style-type: none"> <li>• Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products etc</li> </ul>		
Petroleum & Natural Gas	49%	Automatic
<ul style="list-style-type: none"> <li>• Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs</li> </ul>		
Defence Manufacturing	100%	Automatic up to 49%
<ul style="list-style-type: none"> <li>• Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs</li> </ul>		Above 49% under Government route in cases resulting in access to modern technology in the country
Broadcasting	100%	Automatic
<ul style="list-style-type: none"> <li>• Teleports(setting up of up-linking HUBs/Teleports)</li> <li>• Direct to Home (DTH)</li> <li>• Cable Networks (Multi System operators (MSOs) operating at National or State or District level and undertaking upgradation of networks towards digitalization and addressability</li> <li>• Mobile TV</li> <li>• Head end-in-the Sky Broadcasting Service(HITS)</li> </ul>		
Broadcasting	100%	Automatic
<ul style="list-style-type: none"> <li>• Cable Networks (Other MSOs not undertaking up gradation of networks towards digitalization and addressability and Local Cable Operators (LCOs)</li> </ul>		
Broadcasting	100%	Automatic
<ul style="list-style-type: none"> <li>• Cable Networks (Other MSOs not undertaking up gradation of networks towards digitalization and addressability and Local Cable Operators (LCOs)</li> </ul>		
Broadcasting Content Services	49%	Government
<ul style="list-style-type: none"> <li>• Terrestrial Broadcasting FM(FM Radio)</li> <li>• Up-linking of 'News &amp; Current Affairs' TV Channels</li> </ul>		
Up-linking of Non-'News & Current Affairs' TV Channels/ Down-linking of TV Channels	100%	Automatic
Print Media	26%	Government
<ul style="list-style-type: none"> <li>• Publishing of newspaper and periodicals dealing with news and current affairs</li> <li>• Publication of Indian editions of foreign magazines dealing with news and current affairs</li> </ul>		

FOREIGN INVESTMENT

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Sector	FDI Limit	Entry Route & Remarks
Publishing/printing of scientific and technical magazines/specialty journals/ periodicals, subject to compliance with the legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting	100%	Government
Publication of facsimile edition of foreign newspapers	100%	Government
Civil Aviation – Airports	100%	Automatic
<b>• Green Field Projects &amp; Existing Projects</b>		
Civil Aviation – Air Transport Services	100%	Automatic up to 49%
<ul style="list-style-type: none"> <li>• Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline</li> <li>• Regional Air Transport Service</li> <li>• Foreign Airlines are barred from Investing in Air India</li> </ul>		Above 49% under Government route 100% Automatic for NRIs
Civil Aviation	100%	Automatic
<ul style="list-style-type: none"> <li>• Non-Scheduled Air Transport Service</li> <li>• Helicopter services/seaplane services requiring DGCA approval</li> <li>• Ground Handling Services subject to sectoral regulations and security clearance</li> <li>• Maintenance and Repair organizations; flying training institutes; and technical training institutions</li> </ul>		
Construction Development: Townships, Housing, Built-up Infrastructure	100%	Automatic
Industrial Parks (new & existing)	100%	Automatic
Satellites- establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO	100%	Government
Private Security Agencies	74%	Automatic up to 49%
		Above 49% & up to 74% under Government route
Telecom Services	100%	Automatic up to 49%
		Above 49% under Government route
Cash & Carry Wholesale Trading	100%	Automatic
E-commerce activities	100%	Automatic
<ul style="list-style-type: none"> <li>• E-commerce entities would engage only in Business to Business (B2B) e-commerce and not in Business to Consumer (B2C) e-commerce</li> </ul>		
Single Brand retail trading	100%	Automatic up to 49%
<ul style="list-style-type: none"> <li>• Local sourcing norms will be relaxed up to three years and a relaxed sourcing regime for another five years for entities undertaking Single Brand Retail Trading of products having 'state-of-art' and 'cutting edge' technology.</li> </ul>		Above 49% under Government route
Multi Brand Retail Trading	51%	Government
Duty Free Shops	100%	Automatic

Railway Infrastructure	100%	Automatic
Construction, operation and maintenance of the following		
<ul style="list-style-type: none"> <li>• Suburban corridor projects through PPP</li> <li>• High speed train projects</li> <li>• Dedicated freight lines</li> <li>• Rolling stock including train sets, and locomotives/coaches manufacturing and maintenance facilities</li> <li>• Railway Electrification</li> <li>• Signaling systems</li> <li>• Freight terminals</li> <li>• Passenger terminals</li> <li>• Infrastructure in industrial park pertaining to railway line/ sidings including electrified railway lines and connectivities to main railway line</li> <li>• Mass Rapid Transport Systems</li> </ul>		
Asset Reconstruction Companies	100%	Automatic
Banking- Private Sector	74%	Automatic up to 49%
		<b>Above 49% &amp; up to 74% under Government route</b>
Banking- Public Sector	20%	Government
Credit Information Companies (CIC)	100%	Automatic
Infrastructure Company in the Securities Market	49%	Automatic
Insurance	49%	Automatic
<ul style="list-style-type: none"> <li>• Insurance Company</li> <li>• Insurance Brokers</li> <li>• Third Party Administrators</li> <li>• Surveyors and Loss Assessors</li> <li>• Other Insurance Intermediaries</li> </ul>		
Pension Sector	49%	Automatic
Power Exchanges	49%	Automatic
White Label ATM Operations	100%	Automatic
Financial services activities regulated by RBI, SEBI, IRDA or any other regulator	100%	Automatic
Pharmaceuticals (Green Field)	100%	Automatic
Pharmaceuticals (Green Field)	100%	Automatic
Pharmaceuticals (Brown Field)	100%	Automatic up to 74%
		<b>Above 74% under Government route</b>
Food products manufactured or produced in India	100%	Government
<ul style="list-style-type: none"> <li>• Trading, including through e-commerce, in respect of food products manufactured or produced in India</li> </ul>		

## INCOME TAX SLAB RATES FOR FY 2017-18

For FY 2017-18, the slab rate for income tax up to Rs. 5 lakh has gone down from 10% to 5%.

### ► Income Tax Slab for Individual Tax Payers & HUF/ Less Than 60 Years Old. Both Men & Women

Income Slab	Tax Rate
Income up to Rs 2,50,000*	No tax
Income from Rs 2,50,000 – Rs 5,00,000	5%
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%
<b>Surcharge:</b> 10% of income tax, where total income exceeds Rs.50 lakh up to Rs.1 crore	
<b>Surcharge:</b> 15% of income tax, where the total income exceeds Rs.1 crore	
<b>Cess:</b> 3% on total of income tax + surcharge	

### ► Income Tax Slab for Senior Citizens/ 60 Years Old Or More but Less than 80 Years Old. Both Men & Women

Income Slab	Tax Rate
Income up to Rs 3,00,000*	No tax
Income from Rs 3,00,000 – Rs 5,00,000	5%
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%
<b>Surcharge:</b> 10% of income tax, where total income exceeds Rs.50 lakh up to Rs.1 crore	
<b>Surcharge:</b> 15% of income tax, where the total income exceeds Rs.1 crore	
<b>Cess:</b> 3% on total of income tax + surcharge	

### ► Income Tax Slab for Senior Citizens/ 80 Years Old Or More. Both Men & Women

Income Slab	Tax Rate
Income up to Rs 2,50,000*	No tax
Income up to Rs 5,00,000*	No tax
Income from Rs 5,00,000 – 10,00,000	20%
Income more than Rs 10,00,000	30%
<b>Surcharge:</b> 15% of income tax, where total income exceeds Rs.1 crore	
<b>Cess:</b> 3% on total of income tax + surcharge	

## INCOME TAX SLAB FOR DOMESTIC COMPANIES FOR FY 2017-18

The tax rate for companies with an annual turnover of up to Rs 50 crore has been brought down to 25% from 30%. In other cases, the tax rates remain unchanged at 30% (plus applicable surcharge and education cess).

## GOODS AND SERVICE TAX (GST) - NEW INDIRECT TAX REGIME

The introduction of Goods and Services Tax (GST) would be a very significant step in the field of indirect tax reforms in India. By amalgamating a large number of Central and State taxes into a single tax, it would mitigate cascading or double taxation in a major way and pave the way for a common national market. From the consumer point of view, the biggest advantage would be in terms of a reduction in the overall tax burden on goods, which is currently estimated to be around 25%-30%. Introduction of GST would also make Indian products competitive in the domestic and international markets. Studies show that this would have a boosting impact on economic growth. Last but not the least, this tax, because of its transparent and self-policing character, would be easier to administer.

## GST AND CENTRE-STATE FINANCIAL RELATIONS

Currently, fiscal powers between the Centre and the States are clearly demarcated in the Constitution with almost no overlap between the respective domains. The Centre has the powers to levy tax on the manufacture of goods (except alcoholic liquor for human consumption, opium, narcotics etc.) while the States have the powers to levy tax on sale of goods. In case of inter-State sales, the Centre has the power to levy a tax (the Central Sales Tax) but, the tax is collected and retained entirely by the originating States. As for services, it is the Centre alone that is empowered to levy service tax. Since the States are not empowered to levy any tax on the sale or purchase of goods in the course of their importation into or exportation from India, the Centre levies and collects this tax as additional duties of customs, which is in addition to the Basic Customs Duty. This additional duty of customs counter balances excise duties, sales tax, State VAT and other taxes levied on the like domestic product. Introduction of GST would require amendments in the Constitution so as to concurrently empower the Centre and the States to levy and collect the GST.

## SALIENT FEATURES OF GST

The salient features of GST are asunder:

1. GST would be applicable on "supply" of goods or services as against the present concept of tax on the manufacture of goods or on sale of goods or on provision of services
2. GST would be based on the principle of destination based consumption taxation as against the present principle of origin based taxation

3. It would be a dual GST with the Centre and the States simultaneously levying it on a common base. The GST to be levied by the Centre would be called Central GST (CGST) and that to be levied by the States [including Union territories with legislature] would be called State GST (SGST). Union territories without legislature would levy Union territory GST (UTGST)
4. An Integrated GST (IGST) would be levied on inter-State supply (including stock transfers) of goods or services. This would be collected by the Centre so that the credit chain is not disrupted
5. (v) Import of goods would be treated as inter-State supplies and would be subject to IGST in addition to the applicable customs duties
6. (vi) Import of services would be treated as inter-State supplies and would be subject to IGST
7. (vii) CGST, SGST /UTGST & IGST would be levied at rates to be mutually agreed upon by the Centre and the States under the aegis of the GSTC
8. (viii) GST would replace the following taxes currently levied and collected by the Centre: a) Central Excise Duty

## BENEFITS OF GST

### ► Make in India

1. Will help to create a unified common national market for India, giving a boost to Foreign investment and "Make in India" campaign
2. Will prevent cascading of taxes as Input Tax Credit will be available across goods and services at every stage of supply
3. Harmonization of laws, procedures and rates of tax
4. It will boost export and manufacturing activity, generate more employment and thus increase GDP with gainful employment leading to substantive economic growth
5. Ultimately it will help in poverty eradication by generating more employment and more financial resources;
6. More efficient neutralization of taxes especially for exports thereby making our products more competitive in the international market and give boost to Indian Exports
7. Improve the overall investment climate in the country which will naturally benefit the development in the states
8. Uniform SGST and IGST rates will reduce the incentive for evasion by eliminating rate arbitrage between neighboring States and that between intra and inter-state sales
9. Average tax burden on companies is likely to come down which is expected to reduce prices and lower prices mean more consumption, which in turn means more production thereby helping in the growth of the industries. This will create India as a "Manufacturing hub".

### ► Make in India

1. Simpler tax regime with fewer exemptions
2. Reductions in the multiplicity of taxes that are at present governing our indirect tax system leading to simplification and uniformity
3. Reduction in compliance costs - No multiple record keeping for a variety of taxes - so lesser investment of resources and manpower in maintaining records

1. Simplified and automated procedures for various processes such as registration, returns, refunds, tax payments, etc
2. All interaction to be through the common GSTN portal- so less public interface between the taxpayer and the tax administration
3. Will improve environment of compliance as all returns to be filed online, input credits to be verified online, encouraging more paper trail of transactions
4. Common procedures for registration of taxpayers, refund of taxes, uniform formats of tax return, common tax base, common system of classification of goods and services will lend greater certainty to taxation system
5. Timelines to be provided for important activities like obtaining registration, refunds, etc
6. Electronic matching of input tax credits all-across India thus making the process more transparent and accountable

► **Benefit to Consumers**

1. Final price of goods is expected to be lower due to seamless flow of input tax credit between the manufacturer, retailer and service supplier
2. It is expected that a relatively large segment of small retailers will be either exempted from tax or will suffer very low tax rates under a compounding scheme- purchases from such entities will cost less for the consumers
3. Average tax burden on companies is likely to come down which is expected to reduce prices and lower prices mean more consumption

**ALTERNATIVE DISPUTE RESOLUTION**

The legislature enacted the Arbitration & Conciliation Act, 1996 (“Act”) to make arbitration, domestic and international, more effective in India. The Act is based on the UNCITRAL Model Law (as recommended by the U.N. General Assembly) and facilitates International Commercial Arbitration as well as Domestic Arbitration. Under said Act, an arbitral award can be challenged only on limited grounds and in the manner prescribed. India is also party to the New York Convention on The Recognition and Enforcement of Foreign Arbitral Awards, 1958 (“NYC”).

The following are the different kinds of Arbitrations found in India:

- |   |  |
|---|--|
| <ol style="list-style-type: none"> <li>a. Ad-hoc Arbitration – One in which there is no institution to administer the arbitration.</li> <li>b. Institutional Arbitration – Usually administered by an arbitral institution</li> </ol> | <ol style="list-style-type: none"> <li>c. Statutory Arbitration – Imposed on the parties by operation of law</li> <li>d. Foreign Arbitration – Proceedings are conducted in a place outside India</li> </ol> |
|---|--|

**ENFORCEMENT OF FOREIGN AWARDS AND JUDGMENTS**

India is a signatory to the NYC as well as the Geneva Convention. Thus, if a party receives a binding award from another country which is a signatory to the NYC or the Geneva Convention and is notified as a reciprocating country by India, the award would be automatically enforceable in India. The condition of reciprocity would only apply to the country where the award is made.

The enforceability of a foreign court judgment in India depends upon whether the judgment has been passed by a court in a “reciprocating territory” or whether it has been passed by a court from a non-reciprocating territory. A “reciprocating territory” is notified by the Government of India as a “reciprocating territory” under section 44A of the Civil Procedure Code (CPC). For instance, U.K. has been notified by the Government of India as a reciprocating territory, whereas, the U.S. has not been so recognized. The judgment of a foreign court is enforced on the principle that where a court of competent jurisdiction has adjudicated upon a claim, a legal obligation arises to satisfy the claim. Judgments of specified courts in reciprocating countries can be enforced directly by execution proceedings as if these foreign judgments are decrees of the Indian courts. A foreign judgment of non-reciprocating countries can be enforced in India only by filing a suit based on the judgment and has to be proven as evidence under the provisions of the Indian Evidence Act.

A foreign judgment would be recognized by Indian courts unless it is proven that:

- |   |   |
|---|---|
| 1. It was pronounced by a court which did not have jurisdiction   | 4. Principles of natural justice were ignored by the foreign court  |
| 2. It was not given on the merits of the case   | 5. The judgment was obtained by fraud                               |
| 3. It appeared, on the face of the proceedings, to be founded on an incorrect view of international law or a refusal to recognize Indian law (where applicable) | 6. The judgment sustained a claim founded on a breach of Indian law |



# Cajola & Associati

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Italy

## General information

Cajola & Associati has a tradition of excellence as to the quality of the legal services provided to our clients. Established in Milan in 1966 by Avvocato Alberto Cajola, Cajola & Associati is a domestic and international general legal practice. Our clients are public and privately held industrial, commercial as well as financial businesses, involved in complex corporate and financial transactions and dispute resolution proceedings. The firm has a wide experience in all legal aspect of life of companies since their incorporation and start up of their businesses including the negotiation and settlement of joint venture agreements, supplies of goods and services, agency, distribution and franchising agreements, as well as equity based and asset based transactions and their related tax aspects.

Our team of professionals have developed a specific expertise in takeovers and mergers, and in the buying and selling of businesses. The firm practice is also concerned with issues of domestic & cross border contracts, corporate, corporate finance, banking, taxation, corporate restructuring, real estate and construction, intellectual and industrial property, information technology, aviation and EU Law. As well, the Firm assists its clientele on subject matters involving regulatory compliance and periodic mandatory filings before the main public bodies (UIIC, ISVAP, CONSOB and Banca d'Ita-

lia etc.). Cajola & Associati also provides specialized and general legal representation in any kind of civil and commercial disputes and litigations on matters as such as tax law, labor law, social security law, agency, distributorship, as well as intellectual and industrial property rights, advertising, media law, transport & insurance, product liability and arbitration.

In the area of Intellectual property, our team of IP lawyers deals with major cases relating to the enforcement and prosecution of trademark and patent rights, copyrights, industrial design and web domain name rights on behalf of both domestic and foreign IP right-holders. Specifically, we advise companies with the implementation of preventative strategies aiming at protection of their IP rights against infringement and unfair competition, representing them before governmental authorities and custom administrations and coordinating, if necessary, an activity of intelligence within the national territory and abroad.

Moreover, the Firm advises and represents companies and individuals on legal matters regarding properties and estates situated in Italy or affected by domestic law. Furthermore, we provide legal counselling and representation on any aspect of the areas of labour, Employment & industrial relations regulating relationship with personnel.

In this area, the firm enjoys a broad experience in collective and individual labour related claims, social security claims, and arbitration proceedings concerning employees and managers.

Our primary commitment has always been the devotion to giving legal assistance and representation of the highest quality to our clients. We accomplish this purpose within the perspective that legal problems are essentially business problems for our clients. Our assistance consists in giving them practical advices and fast responses, anticipating their needs.

When the matter requires specialized expertise in different areas of the law, our lawyers use to work together to ensure the highest standard of skills, knowledge and creativity. Our policy is to provide our clients with the best possible legal services, and to enable them to solve their problems at hand, at a cost effective price.

### Head Office

Via G.Rossini,5 - 20122 Milan, Italy

☎ +39 02 76003305

☎ +39 02 780177

law@cajola.com

www.cajola.com

## • Regulations and rules

Since 1 January 2004, Italy has enacted new rules for company formation, start up, organization and administration.<sup>1</sup> This reform has brought Italian company law into line with that of other most advanced countries, introducing simplifications and greater flexibility for corporate decision-making. The new rules have replaced those, which had been in place for 60 years.

The key element of the reform is self-regulation, which allows companies vast powers to establish specific rules in their By-Laws and Articles of incorporation, without too many strict, pre-defined mandatory requirements. Other examples of flexibility can be found in the many financial tools available as well as in the different corporate governance forms. The reform amended and supplemented portions of the Italian Civil Code and modified Italy's Unified Text of provisions on financial intermediation, which now include specific provisions for listed companies<sup>2</sup>.

Overall the 2004 reform successfully introduced changes to the structure of limited companies which simplify and speed up the procedures for establishing a business, new financial instruments for companies to create special categories of shares and new rules providing greater flexibility and choice in corporate governance. Corporate responsibility for groups clarifying issues related to liability, transparency and publicity.

## • Types of business associations and liability of shareholders

Prospective foreign investors wanting to set up a business in Italy with a more permanent presence other than establishing a mere representative office or a branch may decide to incorporate a company.

By considering doing so, they will need to choose the most suitable organizational structure in accordance with the nature of their businesses.

Foreign investors are free to adopt any of the forms of business entities available to Italian citizens. The type of entity chosen will largely depend on the strategy to be adopted, as well as on management, financial and taxation considerations.

<sup>1</sup> Legislative Decree No. 6/2003

<sup>2</sup> Civil code, Articles 2257 through 2510 and Act No. 58/1998, known as "TUF". TUF has been significantly amended by means of Act No. 262/2005, which provides rules aimed to safeguard savings.

## • Capital Companies and Partnerships

Types of business associations may be classified in two categories created by the law, depending on the circumstance that they are organized on a stock capital basis (“*società di capitali*” or capital companies) or on a personal basis (“*società di persone*” or partnerships).

The difference between the two categories is that only the capital companies are regarded as having a legal entity entirely separate and distinct from the individuals who compose it, with the capacity of continuous existence<sup>3</sup> or succession and having as capacity that of taking holding and conveying property.

A capital company’s liability is normally limited to its assets and the stock or quota holders are protected against personal liability in connection with the business of the company

There is an exception to the above distinction that is represented by a rarely used business association structure, the so called “*società in accomandita per azioni*” or Partnership Limited by Shares that is a form of company organized on a stock capital basis, where two category of shareholders exist: Those who enjoy the shield of corporate privilege of this business association and do not respond on a personal basis for the obligations of the limited share partnership (“*soci accomandanti*”) and those who are instead entrusted with the management of the company and are as well personally liable for the obligations (“*soci accomandatari*”). The main types of business associations provided for in the Civil code are the following.

## • Capital Companies and Partnerships

Only the Corporation (*Società per Azioni*) and the Limited Liability Company (*Società a Responsabilità Limitata*) possess full and separate legal identity. Foreign investors usually choose one of these two structures to minimise potential liability exposure. *Società per Azioni* and *Società a Responsabilità Limitata* may be deemed respectively close to the Public and Private Companies in United Kingdom, as well as to the Corporation and Limited Liability Companies in the United States of America. Capital companies are:

**LIMITED LIABILITY COMPANY** (“*SOCIETÀ A RESPONSABILITÀ LIMITATA – S.R.L.*”)

Small or medium-sized enterprises may adopt the Limited liability company form to run their businesses in Italy.

This form of business association – with a minimum capital contribution required of € 10,000<sup>4</sup> – enjoys a great degree of internal flexibility in terms of management and control that makes it attractive to closely held enterprises. This flexibility leaves the stockholders free to develop their organizational structure and to some extent their own management rules and principles.

Stockholders are not personally liable for debts of a Limited liability company, unless the following circumstances concur altogether:

- Sole Stockholder Company
- Insolvency of the company
- Stock contributions have not been fully paid in, rules concerning payment of the stock or rules regarding duty of legal publicity have not been observed.<sup>5</sup>

In the above circumstances, the stockholder is personally liable for debt of the company.

The contribution of a stockholder may be cash, property and services as long as a contribution can be financially evaluated. Participation of a member is a quota that cannot be represented by shares.

**CORPORATION** (“*SOCIETÀ PER AZIONI – S.P.A.*”)

In a Corporation, the capital holdings of members are represented by shares. The Corporation has the same major features as the corporate form in most other countries. A Corporation is governed by the shareholders at the general meeting, by the directors and the board of statutory auditors. Its statutory regulation provides that circulation of corporate capital is a relevant factor in order to classify:

- Companies without outstanding shares held by public investors (Closely Held Corporations)
- Companies with outstanding shares held by public investors, namely, companies issuing stock shares that are traded on regulated markets or circulating in the market on a relevant scale, that means circulating among Italian issuers with net capital not less than € 5 million and with a number of shareholders or bondholders greater than 200). Specific rules are provided for these public companies.<sup>6</sup>

There is a minimum capital contribution required of € 120,000.

<sup>4</sup> Civile code, Article 2463.

<sup>5</sup> Civile code, Articles 2462 and 2464.

<sup>6</sup> Civile code, Article 2325bis and TUF.

<sup>7</sup> Civil code, Article 2327.

## PARTNERSHIP LIMITED BY SHARES

(“Società in Accomandita per Azioni – S.A.P.A.”)

Very rarely used<sup>8</sup>, this structure has the same features of Limited partnerships and stock companies. Their share capital consists of stocks and shareholders are divided into two groups: general partners, who manage the company and have unlimited, collective and contingent liability; and limited partners, whose exposure to debt is limited to the shares each underwrote, and who cannot carry out management activities within the company.

In case of plurality of Directors, the appointment of a new director is subject to the approval of the other Directors.<sup>9</sup>

## PARTNERSHIP

Partnerships are not legal entities distinct from its members, although they may acquire property and assume obligations in their own trade name. They are:

► **Simple Society** (“Società semplice”)

*Rarely used, the main feature of this business structure would be used for the exclusive purpose of non commercial economic activities, such as for instance the management of small real estate property or agricultural activities.*

► **General Partnership** (“Società in Nome Collettivo”)

*The partners have unlimited liability for the partnership’s obligations.<sup>10</sup> A general partnership may not have a corporate partner. An SNC may transact business, acquire, hold property, sued and be sued in its own trade name. It must operate under a business name that includes the name of one or more of the partners and indicates the partnership relationship. No minimum level of capital contribution is required, and contributions may be in the form of cash, property or services. The consent of all partners is required for the transfer of a partnership interest.*

*Partnership profits and losses are distributed in proportion to each partner’s contribution, unless otherwise stated in the partnership agreement. Any stipulation in the partnership agreement limiting the extent of a partners’ losses is void.*

► **Limited Partnership** (Minimum and Minimum paid in amount)

- Amount of stated capital in corporations (s.p.a.) and capital contributions - The minimum amount required is € 120,000. Nevertheless companies existing on January 1, 2004 does not have to comply with such new rule until their duration stated in the By-Laws elapses. As a condition of the incorporation, shareholders must subscribe

<sup>8</sup> Save for a noteworthy exception, that is “Giovanni Agnelli & C. S.a.p.a.”, the holding company of “Fiat Group”.

<sup>9</sup> Civil code, Article 2457.

<sup>10</sup> Civil code, Article 2291.

<sup>11</sup> Civil code, Article 2313.

the entire stated capital. Shareholders shall pay upon subscription at least 25% of the stated capital (if there is a sole shareholder, deposit of the stated capital as a whole is required). The term for restitution to the company of the percentage deposited in the bank for subscription of the shares has been reduced to 90 days. If the shares have not been entirely paid in, it is not possible for the company to increase its stated capital.

- Amount of stated capital in limited liability companies (s.r.l.) and capital contributions - The minimum amount required is € 10,000. The same rules concerning the entire subscription of the stated capital, the payment of the 25% of the stated capital and the eventual contributions in kind apply. Differently from corporations contribution of a quota-holder may be also intellectual property and labour services as long as the contribution may be economically appraised. Contributions by members of limited liability companies cannot be represented by shares, nor they can be publicly traded. If the Articles of incorporation do not provide differently, participation of the members is determined in proportion with the contribution. The Articles of incorporation may provide for granting to single members of special rights relating to the management of the company or the distribution of profit.<sup>12</sup>

## • Classes of shares

Stock shares in Corporations – Corporations are generally authorized according to their By-Laws to issue different classes of stock, which may differ in their right to dividends, their voting rights and their right to share.

The of shares with no par value is now allowed in Italy. Shares may be linked to a fraction of the stated capital, as well as it is possible for Limited liability companies. The only requirement is to make express reference about it in the By-Laws.

Nominal shares are transferable upon authenticated signature. Bearer shares are transferred with delivery of the certificate. Power to exercise corporate rights is transferred upon signature. If the share transfer is conditioned the acceptance by either the other shareholders or the Board of Directors, By-Laws shall provide that in the event that such acceptance is denied:

- The company and/or its shareholders undertake to purchase the share
- The seller has a right to withdraw at expense of the company and/or its shareholders<sup>13</sup>

In order to be enforceable stock transfer restrictions must be mentioned on the stock certificate. Issue of redeemable shares is now permitted.<sup>14</sup> Redeemable shares may be relevant in the event that participation in the stock capital is connected to a specific relationship from outside the company.

In case of assignment of shares, the transferor is jointly and severally liable with the transferee for a period of three years from the date of the transfer for payments still due on the shares.

<sup>12</sup> Civil code, Article 2468.

<sup>13</sup> Civil code, Article 2355bis.

<sup>14</sup> Civil code, Article 2437sexies.

## PRINCIPAL CLASSES OF SHARES

The following are the principal classes of shares:

- **Common Stock** – Full voting rights, save for those shares issued for specific corporate business activities
- **Non-voting Stock** – They have no voting rights. Such shares may be only issued by companies whose shares are traded on the Stock exchange for an amount of stock capital not greater than 51%
- Stock having different rights If there is specific provision in the By-Laws it is possible to create categories of stock having different rights even with reference to a predetermined and actual level of losses
- **Stock of participation to a determined business** – Financial instrument of participation, whose rights must be specifically predetermined
- **Stock and other instruments for to the benefit of employees** – The extraordinary general meeting has the power to determine assignments, rules, rights, eventual expiration terms and facility for repurchase

A corporation may authorize – not more than 51% of stock capital – specific stock without voting rights, with restricted voting rights, with limited or subordinated voting rights.<sup>15</sup>

Stock for the benefit of employees or issued pursuant to services or work carried out by shareholders or third parties may carry the right to vote on specific arguments of particular interest for the rights of the stock itself and a member of the controlling board may represent them. The mandatory deposit with consequent prohibition of withdrawal of the shares for a corporate meeting has been eliminated.

## SHARES REPRESENTING ASSETS DEDICATED TO SPECIFIC BUSINESS

Corporations may dedicate and link a proportion of the stock, (not more than 10% of the stock capital), to the results of a determined area of business (with the exclusion of business activities with a reserved statutory regulation).<sup>16</sup> To that extent, a corporation may:

- Set up one or more assets specifically dedicated to the realization of a specific business (a single business or an entire business activity to be carried out along with the main business activity of the company)
- Establish that financial resources necessary for carrying on the activity have to come from the specific business itself

<sup>15</sup> Civil code, Article 2351.

<sup>16</sup> Civil code, Article 2457.

The purpose of this regulation is to allow for split management and to enable different activities and businesses to be valued independently. Possible purposes are:

- **Disposition of assets** – Setting up of a separate corporate entity internal to the company, without the need to deal with rules and regulations of the Civil Code applicable to de-merge of companies, therefore without bearing related costs (i.e. investment of corporate equity in financial speculations aimed at risk diversification). Where there is provision in the Bylaws offsetting out the criteria for calculation of income and expenditure for the specific business, the issuance of stock directly linked to results of the specific business is permitted
- **New contributions and need of new resources for developing a new project** – Separate accounting for the specific business activity is mandatory (Contributors may decide on the basis of the substance and the content of the single project or operation)

A specific resolution of the Shareholders Meeting is necessary in order to bind some assets to a specific business. The meeting shall determine:

- The object of the business
- Assets involved
- Contributions specifically undertaken and financial instruments issued for the operation
- Appointment of an auditing company in case the corporation issues equity securities publicly traded and offered to non professional investors
- Rules of accounting of the specific business
- Financial and economical business plan (in order to determine congruity, criteria of management, expected result, guaranties etc.)

The resolution must be filed with the Companies Registry. Actual creditors may file an objection within two months from the filing.

## • Debt Securities

Corporations are allowed to issue debt securities offered to the market for subscription. The decision to issue debt securities as a financial instrument, may be led by the:

- Preference of raising financial resources without granting new subjects the right to vote and without altering corporate control
- Circumstance that the purchase of equity stock is not a sound investment during a particular period of time.
- Necessity of financing projects or operations, which only need a temporary financing



Issuance of equity security instead may sound convenient for raising permanent resources, acquiring new resources without paying additional financial costs, or financing the stock capital without being subject to statutory limitations provided for the issuance of debt securities.

Unless otherwise provided by either the certificate of incorporation or the bylaws, the Board of Directors may adopt the resolution for issuance of debt securities. The extraordinary general meeting may vote for issuance of convertible bonds. To be enforceable, the resolution of issuance must be entered in the minutes of the meeting and must be filed in accordance with the regulation established for By-Laws amendments.

The threshold for the issue of debt security has now been raised to an amount equal to twice the aggregate of the stock capital, of the legal reserve and of the available reserves as shown on the last approved balance sheet. It would seem possible to make reference to the subscribed stock capital and not to the stock capital paid in, since the law is silent in this respect. The following situations are not subject to the above limitations:

- Bonds issued in excess that are subscribed by professional investors subject to prudential control in accordance with specific regulations and that are traded among non professional purchasers (situation where bond subscribers are liable for the solvency of the company).
- Bonds backed by first mortgage over real estate owned by the company up to 2/3 of their value
- Authorization by governmental authority

Rules and regulations concerning convertible bonds has not changed (extraordinary General Meeting + stated capital increase for an amount equal to the shares to issue in conversion). Stated capital must be entirely paid in.

## • Corporate governance

### CORPORATE GOVERNANCE IN LIMITED LIABILITY COMPANIES

In Limited Liability companies, the By-Laws may contain a provision that management is undertaken by a:

**Sole Director**

**Board of Directors, whose members exercise their actions jointly. In this case statutory rules regulating management of partnerships apply to Limited Liability Companies. <sup>18</sup> Therefore:**

- Unanimous consent of all the Directors is required for company's actions
- Single Directors cannot carry out any action on their own, save when there is necessity to avoid damage to the company.

**Board of Directors, whose members may act individually. In this latter case:**

- Each Director may exercise her/his office individually
- The power to manage the company belongs to any stockholder with unlimited liability

Certain company's actions (annual financial reports drafting, merger or de-merger plan and capital increase plan drafting) may only be exercised by the Directors altogether, by way of majority quorum or the different quorum that the By-Laws of the company may set forth.<sup>19</sup>

In Limited Liability companies, even if Directors exercise their activity jointly, it cannot be said that the Board is a collective body. In fact there may be a provision in the Articles of Incorporation of Limited liability companies establishing that Directors' resolutions must be adopted by way of written consultation or by way of express written consent (even via fax or e-mail if bearing signature). The statutory provisions of consultancy and of written consent imply that an action is undertaken by a single Director and that resolutions are adopted without the need for a meeting of the Board of Directors.

## CORPORATE GOVERNANCE IN CORPORATIONS

In Corporations, different models of corporate governance may be adopted. By-Laws may regulate more freely the internal organization of the Board competent for management, its functioning, the circulation of information among its members and the members of the Board of Auditors. If By-Laws do not provide otherwise the model of corporate governance and control applied is still represented by the traditional system.

### ► Traditional System

*In Corporations, different models of corporate governance may be adopted. By-Laws may regulate more freely the internal organization of the Board competent for management, its functioning, the circulation of information among its members and the members of the Board of Auditors. If By-Laws do not provide otherwise the model of corporate governance and control applied is still represented by the traditional system.*

<sup>18</sup> Civil code, Article 2351.

<sup>19</sup> Civil code, Article 2473.

A Provision of the Civil Code establishes that the office term for appointed directors is the same office term set of directors appointed by the time of their election.<sup>20</sup> In case of conflict of interest, the executive director shall refrain from undertaking operations and shall empower the Board of Directors for their enforcement. If a resolution would have not been approved without the vote of the director in conflict of interest, such resolution may be challenged within 90 days, and during this period of time operations carried out with bona fide third parties are valid.

Directors and members of the Board of Auditors "...must act with the same professionalism and diligence required by the nature of the action undertaken".<sup>21</sup> Such standard does not require Directors to be necessarily experts on accounting, finance and any other sector of management and governance of the enterprise, rather it means that their decisions shall be informed and pondered, based on knowledge and on a calculated risk, and not on irresponsible and negligent improvisation.

### ► Dualistic System (German tradition)

It may be established on By-Laws that governance of the company is exercised by the Management Board, which is appointed by the Supervisory Board (with the exception of the first election resulting from the certificate of incorporation). Management Board can assign specific executive powers to one or more of its members.

Rules regulating relationship between Board of Directors and the Executive Committee, and directors in general apply to this corporate model. Management Board cannot remain in office for more than three consecutive fiscal years. It may be however be confirmed and removed for "good cause" by the Supervisory Board.

General rules apply to individual claims against members of the Management Board, as well as to claims raised by the Supervisory Board against them. When the resolution is adopted by 51% of its members, the member of the Management Board against whom the claim has been raised, is automatically removed from office.

The Supervisory Board, which exercises general supervision over activity of the company, is elected by the General Shareholders' Meeting (with the exception of the first election resulting from the certificate of incorporation). Both effective (those holding office) and supplemental (substitutes) members are elected. Supplemental members are those who replace effective members in case one or more of these latter resign or cannot otherwise attend her/his duties.

Its membership has to be no less than three. Their office lasts three fiscal years. At least an effective and a supplemental member have to be auditors members of the Roll of Auditors. It is not possible to be member of the Management and of the Supervisory Board at the same time. The Supervisory Board exercises supervision over:

- Compliance with legal and accounting rules and regulations
- Corporate operations, reporting any unlawful act

Moreover, once a year the Board reports to the Management Board. Members of the Supervisory Board share joint and several liability with members of the Management Board for acts and omissions of the latter, whenever the activity of supervision of the Board could have avoided damages.

<sup>20</sup> Civil code, Article 2386.

<sup>21</sup> Civil code, Article 2704.

### ► **Monistic System (British Tradition)**

*By-Laws may set forth that a Board of Directors have the duty of corporate management, but a Committee appointed internally will be appointed for the purpose of supervising the management.*

*This system of governance must be explicitly set out in By-Laws. There is a close connection between the Board of Directors and the Committee for supervision of the management, in fact only those who have been previously elected members of the Board of Directors may serve as members of the Committee.*

*The Board of Directors set the number of members for the Committee (not less than three, if the company solicits investment at large). Half of the members at least must be independent, and further standards and by ethical codes are set by business associations or by legal entities of management of trading markets. It is not allowed to serve at the same time as member of the Committee for supervision of the management and as member of any other Executive Committee.*

*Further, it is not permitted for a member of a Committee for supervision of the management to have specific assignments, powers or offices regarding the management of the company. At least one director, among members of the Committee for supervision of the management must be an auditor member of the Roll of Auditors. The same powers and duties of the Board of Auditors are attributed to the Committee.*

## • **Classes of shares**

The General Meeting may be called at any place within the municipality where the company has its own registered office, unless the Bylaws provide otherwise. The Meeting has to take place once a year within the 120th day after closing of the corporation's fiscal year. By-laws may set a longer period of time not exceeding 180 days for companies required to file a consolidated tax return and when there is a specific need in connection with structure and business activity of the company. In this latter case Directors have to make mention of the deferral in their report.<sup>22</sup>

The following powers previously reserved to the extraordinary general Meeting may be assigned to the Board of Directors, to the Board of Auditors or to the Management Board, if any:

- **Issue of non convertible bonds or of financial instruments without voting rights**
- **Merger with a wholly owned company**
- **Creation or suppression of secondary offices**
- **Attribution of powers of attorney**
- **Capital reduction due to a shareholder's withdrawal**
- **By-Laws amendments in compliance with statutory regulations**
- **Transfer of the registered office within the national territory**

<sup>22</sup> Civil code, Article 2351.

Companies without outstanding shares held by public investors may avoid formalities and requirements established for the call of the meeting (notice on the Official Gazette 15 days before the meeting).

By-Laws may allow calls through means of communication that guarantee the effective knowledge of the call at least 8 days in advance on the date scheduled (Certified letter with receipt, fax are proper means; some doubts about e-mails with automated reading receipt message). Shareholders are not allowed to call the meeting solely on arguments concerning the competence of Directors.

Upon petition by 10% of the Shareholders, the Tribunal may also call the general meeting, but only if the management did not call it without justification. Quorum and majorities for the resolution of the Shareholders Meetings of a corporations are different among closely held and publicly traded corporations. They may be summarized as follows.

#### FIRST CALL

Companies without outstanding shares held by public investors (closely held corporations):

- **Ordinary General Meeting** – In order to effectuate corporate business a quorum of 50% of shares entitled to vote must be represented. Unless Bylaws provide otherwise, shareholder actions must be approved by the majority of shares represented at the meeting and entitled to vote.

**Call formalities need not to be observed if the meeting is attended by:**

- Shares representing the entire capital
- The majority of Directors
- The majority of members of the Board of Auditors

Absentees must be given immediate notice about adopted resolutions. Participants may claim they have not been sufficiently informed on the argument.

- **Extraordinary General Meeting** – Unless Bylaws provide otherwise a quorum of 50% of shares entitled to vote must be represented and shareholder actions must be approved by the majority of shares represented at the meeting and entitled to vote.

Companies with outstanding shares held by public investors (publicly traded corporations):

- **Ordinary General Meeting –**  
Same rules as above
- **Extraordinary General Meeting –** A quorum of 50% of the shares (entitled or not to vote) must be represented and shareholders' actions must be approved by 2/3 of the shares represented at the meeting

## SECOND CALL

If the above quorum required for the first call of the shareholders' meeting are not met, the meeting has to be recalled on another day, within 30 days.

Companies without outstanding shares held by public investors (closely held corporations); Only resolutions on arguments to the order of the day of the first meeting may be adopted, with the following quorum:

- **Ordinary General Meeting –**  
No minimum quorum required
- **Extraordinary General Meeting –** A quorum of more than 1/3 of the shares must be represented and shareholder actions must be approved by 2/3 of the shares represented at the meeting

By-Laws may increase quorum required, but not for annual financial reports approval, appointment and revocation of corporate management.<sup>23</sup> A quorum of at least 1/3 of the shares representing the stated capital is required for passing a resolution on the following arguments:

- **Change of the corporation's purpose**
- **Modification of form of business association, anticipated winding up, extension of duration for the company**
- **Revocation of the winding up procedure**
- **Transfer of the registered office abroad**
- **Issue of preferred stock**

Companies with outstanding shares held by public investors (publicly traded corporations):

- Same quorum set above for those companies which do not solicit investment at large, with the exception of those Extraordinary General meetings with calls subsequent to the second one, where a quorum of at least 1/5 of the shares must be represented to effectuate corporate business.

<sup>23</sup> Civil code, Article 2369.

## • Company's decisions and Quota-holders Meetings in Limited Liability Companies

The powers and attributions of stockholders are set forth in Bylaws.<sup>24</sup> Stockholders shall decide on issues brought to their attention by one or more directors or by 1/3 of shareholders, and on the following matters:

- Balance sheet approval and dividend distribution
- Election of Directors
- Election of Board of Auditors and/or external Auditor
- Amendments to articles of organization
- Resolutions concerning substantial modification to the corporate purpose or concerning relevant modification to the rights of stockholders<sup>25</sup>

There are no specific formalities for adoption of a company's decision. However, there must be a writing wherein the will of stockholders, the matter subjected to decision and consent of stockholders are certified.

The written decision must be reported in the Book of Stockholders' Decisions. This rule evidences that decisions over company's operations do not have necessarily to be adopted by a collective body as long as the above requirements are met.

In order to adopt company's resolutions a quorum of 50% of the stock must be represented.<sup>26</sup> Shareholder actions must be approved by the majority of the stock represented at the meeting, save for those actions concerning:

- Substantial modification to the corporate purpose
- Relevant modification to the rights of stockholders

The above actions must be approved by 50% at least of the stock of the company. It is important to remark that extraordinary meetings are not required anymore for Limited Liability Companies.

The Articles of incorporation of Limited liability companies set forth rules for the call of quota-holder Meetings, with the formalities necessary to ensure information about the arguments subject to discussions (fax and e-mails are proper means of transmission). In absence of specific provisions on the matter, the call must be delivered via registered letter with receipt sent to stockholders at least 8 days before the date set for the meeting. No formalities are required when the entire stock is represented at the meeting and all the Directors and Auditors are either present or informed and no one objects that the discussion over the matter should not take place.<sup>27</sup>

<sup>24</sup> Civil code, Article 2479.

<sup>25</sup> Civil code, Article 2479.

<sup>26</sup> Civil code, Article 2479.

<sup>27</sup> Civil code, Article 2479bis.

## • Decision-making bodies

### QUALIFICATION AND POWERS OF DIRECTORS

The management of the company exclusively belongs to the directors, who perform the actions necessary to the achievement of the corporate object. In corporations, the management of the company may be entrusted to non shareholders. It cannot be entrusted to entities other than individuals.<sup>28</sup>

If more than one person is entrusted, they constitute the Board of Directors. The Board of Directors selects the chairman among its members, unless she/he is appointed by the Shareholders Meeting.

If the By-Laws or the Shareholders Meeting allows so, the Board of Directors may delegate its functions to an executive committee composed by one or more of its members. The Board of Directors set out the content, the limits and the modalities for the exercise of delegated powers. Even when delegates, the Board of directors may always give guidelines to the delegated bodies and bring back anytime power delegated.

On the basis of the information received, the Board of Directors assess the adequacy of the corporate organization, management and accounting structure of the company; it reviews the strategic and industrial plans of the company assessing as well the general trend of the management.

Not all of its functions can be delegated, as for instance the drawing up of annual account, the decisions about issuance of debt securities, the power to increase the stock capital etc.<sup>29</sup>

The delegated bodies take care that the organizational, administrative and accounting structures are adequate to the nature and the size of the company and report to the board of Directors and to the Board of Auditors as the By-Laws set forth and at least every six months, on the general trend of the management and on its expected evolution, as well as on most relevant transactions entered into by the company or by its subsidiaries.

The directors are required to act being informed. Each director may request the delegated bodies to report to the Board about the management of the company.

The powers of representation granted to the directors by either the By-Laws or the Shareholders Meeting are of general character.

<sup>29</sup> Civil code, Articles 2420ter, 2423 and 2443



## QUALIFICATION AND POWERS OF DIRECTORS

The directors are liable to:

- The company, if they have not exercised due care over the general management of the company, they have not done what they could for preventing damages to the company to occur, and they have not fulfilled their duty with the professionalism and diligence required by the nature of the action undertaken. A claim of their responsibility may be promoted by resolution of the General Shareholders' Meeting. With reference to the balance sheet, without previous notice, a claim of responsibility may be carried out during discussion about balance sheet approval by shareholders representing 1/1000 of the stock capital and within the five years subsequent to their removal from office. Outside the General Shareholders' Meeting, even a minority of shareholders may make the claim (1/5 of the stock capital for companies which do not issue capital of risk and 1/20 of the stock capital for the others)
- Creditors of the company, whenever the preservation of the stock assets is not guaranteed and the stock assets are not sufficient to satisfy their credits. In case of bankruptcy, the claim for responsibility may be initiated by the bankruptcy administrator, and in case of extraordinary administration, by the extraordinary administrator.
- The single shareholder or the third may carry out a claim for damages within five years.

## FIDUCIARY DUTIES

As the provisions of the Civil code sets forth, the Directors of a company are required to perform their mandate and to carry out their duties with the diligence of a good pater *familias*.<sup>30</sup> They must fulfil the duties that the law and the By-Laws establish with the diligence required by the nature of the appointment and by their specific skills. Directors are jointly and severally liable to the company for damages arising from the non observance of such duties, save for functions vested solely in the executive committee or in one or ore executive directors.

They are in any event jointly and severally liable if, being aware of prejudicial acts, the directors did not act as they could to prevent their performance or to either eliminate or reduce their harmful consequences.

Liability for acts or omissions of directors does not extend to that director who, being without fault, has had her/his dissent entered without delay in the minute book of the meetings and resolutions of the Board of Directors and has immediately given notice to the Board of Auditors.

<sup>30</sup> Civil code, Articles 1710 and 2392. The standard refers to the diligence that a normally diligent director would use under the same circumstances.

## RESTRICTIONS ON DIRECTORS

Interdicts, bankrupts and those who have been sentenced to a penalty entailing interdiction even though temporary, from public office or incapacity to exercise managerial functions, cannot be appointed as directors and if appointed they forfeit their office.<sup>31</sup>

Also, according to the provisions of the Civil Code<sup>32</sup>, directors cannot act as unlimited liability shareholders in competing ventures, neither can they carry on a concurrent business activity on their own or on behalf of third parties, nor as directors or general managers in competing ventures, unless with explicit authorization by the General Shareholders Meeting.

The directors must inform the other directors and the Board of Auditors of any interest they have on their own behalf or on behalf of third persons in a specific transaction of the company, by specifying its nature, terms, origin and relevance.

In case of interest by a managing director, she/he must abstain from the transaction remitting it to the Board of Directors and giving notice about it at the first appropriate Meeting. The relating resolution by the Board must adequately justify the reasons and the convenience of the transaction for the company.

## REMOVAL OF DIRECTORS

Removal of a director can be effected by a resolution from a Shareholders Meeting. In case of corporations, when in the course of the fiscal year a vacancy of one or more directors occurs, the others provide for their replacement by resolution approved by the Board of Auditors provided that the majority is always constituted by directors appointed by the Shareholders Meeting.

If vacancies of the majority of the directors appointed by the Meeting occur, those who remain in office shall call the Shareholders Meeting to provide for filling the vacancies.<sup>33</sup>

In case of Limited liability companies, there are no specific provisions that the civil code sets forth. Consequently, provisions of the By-Laws have to regulate replacement of the directors.

<sup>31</sup> Civil code, Article 2382.

<sup>32</sup> Civil code, Article 2390.

<sup>33</sup> Civil code, Article 2386.

- **Annual accounts - Financial and operating results: Duties and Liabilities**

The Meeting for approval of the annual balance sheet has to take place once a year within the 120th day after closing of the corporation's fiscal year. By-laws may set a longer period of time not exceeding 180 days for companies required to file a consolidated tax return and when there is a specific need in connection with structure and business activity of the company. In this latter case Directors have to make mention of the deferral in their report.<sup>34</sup>

#### **AUDITORS IN CORPORATIONS: THE BOARD OF AUDITORS**

Only one out of the three or five of the effective members (and one of the supplemental members) of the internal Board of Auditors must be an auditor member of the Roll of Auditors; other members may be chosen among members of other professional categories or among professors in juridical or economical sciences.

According to the statutory provision of the Civil Code<sup>35</sup>, the Board of Auditors exercises a control of Law and Bylaws regulation compliance and over principles of fair management. In other words its duty is to exercise administrative and legal control, while duty of control over accountancy, which characterized the activity of the Board, has been eliminated.

Members of the Board of Auditors have to attend both the Board of Directors' and the General Shareholders' meetings, as well as meetings of the Executive Committee. They are removed if they do not attend without justification two consecutive meetings during a fiscal year. The supervisory board must meet at least each 90 days and may meet through the use of electronic means (e.g. videoconferences).

When some shareholders report an unlawful action by Directors, the Tribunal cannot intervene if the General Shareholders' Meeting substitutes members of the Board of Directors and of the Board of Auditors as a whole, and elect new members of adequate professionalism for curing eventual illegality.

The following cannot be elected members of the Board of Auditors:<sup>36</sup> those who are in the condition listed on Article 2382 (Insanity etc.), parent and relatives within the 4th degree of company's Directors, Directors of the company, parent and relatives within the 4th degree of either controlling or controlled company's

<sup>34</sup> Civil code, Article 2428.

<sup>35</sup> Civil code, Article 2403.

Directors; those who are bound to either the company or to controlling/controlled companies by an employment relationship, a continuative consulting relationship, a remunerated service activity, or by other economical interested relationship that affect their independency.

Among other duties, members of the Board of Auditors have also to certify that a bond issuance does not override legal limitation.<sup>37</sup>

## ACCOUNTING SUPERVISION

Supervision over accounting has to be exercised by an external auditor, who cannot be member of the Board of Auditors. His appointment may be mentioned in the Certificate of incorporation or he may be elected by the General Shareholders' Meeting. Accounting supervision over companies with outstanding shares held by public investors has to be exercised by an auditing company. Accounting supervision over companies without outstanding shares held by public investors and required to have consolidated financial statements may be exercised by an auditor. Accounting supervision over companies without outstanding shares held by public investors and not required to have consolidated financial statements may be exercised by an auditor as well. In this latter situation, however, By-Laws may provide that accounting supervision is exercised by the Board of Auditors, whose members shall be in this case only auditors members of the Roll of Auditors. The auditor is elected by the General Shareholders' Meeting, takes his office for three years and may be removed only for "good cause". His activity of control consists in:

- Drafting a specific auditing report
- Communicating to the Supervisory Board about the existence of any fact deemed to be blamed.

The auditors are required to:

- Verify quarterly during the fiscal year regularity of accounting and fairness of accounting methods applied
- Express with specific report an opinion over the annual balance sheet and the consolidated balance sheet
- Document the activity carried out on a specific book as provided by statutory regulation on mandatory bookkeeping.

<sup>36</sup> Civil code, Article 2399.

<sup>37</sup> Civil code, Article 2412.

The auditing activity is in conflict with the office of member of the Supervisory Board of:

- The company
- Controlling/controlled companies

and with other activities listed in the relevant provisions of Civil code.<sup>38</sup>

## AUDITORS IN LIMITED LIABILITY COMPANIES

In a Limited Liability company, an external Auditor and the internal Board of Auditors exercise accounting supervision. Election of the Board of Auditors is mandatory whenever:

- The stated capital of the company is in the amount equal or superior to the minimum amount (€120,000) of stated capital required for Corporations
- Thresholds set forth in Civil Code, Article 2435bis, allowing a company to file simplified annual financial reports are exceeded for two consecutive years.<sup>39</sup>

If the above thresholds have not been exceeded for two consecutive fiscal years the company is not compelled to maintain the Board of Auditors.

Rules of the Civil Code regulating election and functioning of the Board of Auditors of Corporations apply to Limited Liability Companies as well.

## • Corporate governance issues for Publicly Traded Companies

Pursuant to the general principles indicated by CONSOB (which is the Italian Security Exchange Commission), the managing bodies of publicly traded companies must adopt rules ensuring substantive and procedural transparency and the fairness of the business transactions with related parties and disclose them in the management report. For this task, they may be assisted by independent experts on the basis of the nature, value or characteristics of the business transaction.

The above provisions apply to business transactions directly entered into or through subsidiaries and regulate such transactions in terms of powers, decision, reasonableness and documentation. The supervising body exercises its control over the transaction and has to report to the Shareholders Meeting.

<sup>38</sup> Civil code, Articles 2399 and 2409quinques.

<sup>39</sup> Civil code, Article 2477.

## • Corporate Income Tax (IRES)

Corporate income tax (IRES) is regulated by the Unified Text on direct Taxes (*"Testo Unico Imposte Dirette"*).

<sup>40</sup> Italian resident corporations are subject to IRES on their worldwide income. Non-Italian resident corporations are subject to IRES only on Italian source income.

As of January 1, 2004, the imputation system previously in force has been abolished and replaced with the so called 'partial exemption' method, under which corporate profits are subject to income tax at the level of the company and partially exempted at the level of the shareholders. In addition, other significant measures have been introduced, e.g. reductions in corporate income tax, the participation exemption regime and the domestic tax consolidation regime.

## • Taxable persons, tax rates and taxable period

Corporate Income Tax (IRES) applies to resident and non-resident corporations. Resident corporations are subject to IRES on their worldwide income, so-called 'unlimited taxation'. Non-resident entities are subject to IRES only on income considered sourced in Italy, 'limited taxation'.

Resident corporations include Corporations (*"Società per azioni - Spa"*), Limited liability companies (*"Società a responsabilità limitata - Srl"*), and Partnerships limited by shares (*"Società in accomandita per azioni - Sapa"*). Resident corporations also include companies formed under foreign jurisdictions which, for most of the taxable period, have their statutory office, place of effective management, or main object of their business in Italy. Resident partnerships not limited by shares, are not subject to IRES. Such partnerships, namely *"società in nome collettivo - Snc"*, or *"società in accomandita semplice - Sas"*, are considered transparent entities. For tax purposes, their income is attributed to the partners and subject to tax accordingly. For IRES purposes, the taxable period coincides with the company's financial year, as provided by the law or by the articles of association. Otherwise, the taxable period coincides with the calendar year. IRES is levied at a flat rate of 24%. <sup>41</sup>

<sup>40</sup> Act No. 917/86.

<sup>41</sup> Act No. 917/86.

- **Regional tax on business activities (IRAP)**

Regional tax on business activities, “*Imposta regionale sulle attività produttive – IRAP*”, is a local tax applied on the value of the production generated in each taxable period by persons carrying out business activities in a given Italian region. Non-Italian resident corporations are subject to IRAP only on the production generated through Italian permanent establishments. Rates may vary, though they range around 3.9%.

- **Indirect taxes – Value Added Tax (VAT)**

The Italian value-added tax (VAT) system conforms fully to European Union VAT rules. In principle, the system ensures that VAT is borne by the ultimate consumer only and that, at the upper level, input VAT is deducted by the suppliers of goods and of services. VAT is charged on any supply or service deemed to be made or rendered within the Italian territory. The ordinary VAT rate is set at 22%.<sup>42</sup>

- **Transfer tax**

Transfer tax (“*Imposta di registro*”), is due on specific contracts if formed in Italy, and contracts including those formed abroad, regarding the transfers or leases of business concerns or immovable properties situated within the Italian territory. The taxable base and rates depend on the nature of the contracts and on the status of the parties.

When transferring immovable properties, cadastral and mortgage taxes also apply. These are due for formal transcription in the public registers. The tax base matches that of the transfer tax, with tax rates set respectively at 1% and 2%. Transfer tax, cadastral and mortgage taxes are imposed as a lump sum of €129.11 on transfers of immovable properties subject to VAT. Alternatively, transfer tax rates may vary from 4% up to 15% depending on the type of real property.

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<sup>42</sup> Act No. 633/72.

## • Municipal tax on real estate

Any owner, resident or non-resident, of real properties located within Italian territory must pay annually the municipal tax on immovable property, "*Imposta Municipale Unica - IMU*". This tax is levied at two rates 0.4 % on the value main residences and 0.76% on the value of most other properties. Local authorities can slightly change these rates within their district by + or - 0.2%, by issuing local regulations.

The main residence (*Abitazione principale*) reduced rate of tax (0.40%) is only applicable to actual, habitual abode (*Dimora*) of the taxpayer and his family, provided this appears on public records (*Residenza anagrafica*).

For most residential units, IMU tax will be levied on a statutory property value, calculated by multiplying the land registry income (as it was in the official Italian land registry records for the relevant property on 01.01.2012) by 5 and then by 160. Different figures apply to offices, factories and shops.

## • Municipal tax on real estate

On December 24, 2007 new rules were enacted to regulate inheritance and gift taxes.<sup>43</sup> The inheritance and gift tax is imposed on the value of the share of each beneficiary. The rates vary depending on the relationship between the deceased and the beneficiary, as well as the non-taxable threshold amount.

Inheritances of spouses and direct descendants or ascendants are subject to inheritance tax at a rate of 4% on the amount exceeding €1,000,000 per beneficiary. Transfers to brothers or sisters are taxed at 6% on the amount exceeding €100,000 per beneficiary.

Transfers to relatives up to the fourth degree or relatives-in-law up to the third degree are taxed at 6% on the entire amount of their inheritance. Any other transfer is taxed at 8% on the entire amount.

<sup>43</sup> Act No. 244/07.



# Italy | FOREIGN INVESTMENT

## • Registrations and Permits

There are not specific statutory regulations in Italy providing limitations on foreign investment in the Country. In principle, foreign investments as well as domestic investments can be forbidden only for reasons of public order, public health or other general principles of law.

- **EU Citizens and EU companies** – In accordance with the general principles of EU, foreign EU citizens and EU companies enjoy the same treatment and protection of law as domestic ones.
- **NON EU Companies** – As long as the reciprocity of treatment with another Country is observed, foreign companies are generally allowed to operate, to maintain representative offices or permanent establishments, to incorporate subsidiaries and to participate to domestic business concerns in Italy.

## • Transfer of dividends, interest and royalties abroad

Transfer of dividends, interest and royalties abroad is not restricted. As tax statutory regulations set forth, foreign citizens with fiscal residence in Italy or companies incorporated in Italy or foreign companies without fiscal residence in Italy but having there a permanent establishment, are taxable subjects in Italy and have to pay taxes in accordance with the relevant tax statutory regulations applicable.

Definition of permanent establishment substantially matches the definition that Article 5 of the OECD Model Convention (double taxation) establishes.

Dividends, interest and royalties paid to foreign citizens or foreign companies without fiscal residence in Italy, but with a permanent establishment, are taxed through a withholding tax.

## • Transfer of dividends, interest and royalties abroad

There are three main withholding taxes applicable at source on certain payments: dividend withholding tax, withholding tax on interest, and withholding tax on royalties.

- **Dividend withholding tax** – Dividends received from the 1st of January 2012 by individuals outside the scope of a business activity are subject to a 20% withholding tax in settlement of whereby they concern non qualifying holdings. Qualifying holdings consist of shares (other than savings shares) and any other investment in the capital or equity of a company to which voting rights are linked in the ordinary Shareholders'

Meeting exceeding 2% or 20%, if the securities are traded on a regulated market, or 5% or 25% in other cases. Dividends received from the 1st of January 2012 by individuals outside the scope of a business activity regarding a qualifying holding in Italian companies are not subject to withholding tax, whereas those regarding foreign companies are subject to a 20% withholding tax on account for the taxable portion of profit – i.e. 49.72% of the total (with a consequent filing requirement and deduction of any credit for taxes paid abroad), net of any withholding tax applied in the foreign country. In applying the withholding, account is taken of double taxation agreements which could provide for the reduction or elimination of the tax.

If dividends are distributed to a foreign company resident in a State under a privileged tax regime (tax havens), they shall be subject to taxation in full, unless the taxpayer receives a positive response to an opinion request (interpello) from the Revenue Agency.

From the 1st of January 2012, dividends received by parties other than individuals not resident in Italy are generally subject to a 20% withholding tax in settlement. However, whereby non resident parties are companies or entities subject to corporate income tax in the countries entered in the so-called white list, the rate is equal to 1.375%. Reduced rates are possible under any tax treaties, Italy has concluded with the recipients' country of residence.

The withholding tax is not due, in line with the EU Parent-Subsidiary Directive, for dividends paid by Italian resident corporations to its EU parent company. The benefit is subject the parent's current ownership dating back at least one year, of no less than 25% of the Italian subsidiary's share capital.

- **Withholding tax on interest** – Interests on current accounts and deposit accounts with banks, as well as bonds and similar securities, received by people resident in Italy for tax purposes is subject to a withholding tax of 20%, generally applied on account (gross interest is included in taxable income and the withholding is deducted from the gross tax). However, whereby the interest is received by residents outside the scope of a business activity, the withholding tax is applied in settlement and interest is not part of the overall taxable income.

Interests on current and deposit accounts, as well as bonds and similar securities, received by non-residents is not subject to any withholding tax, with the exception of persons resident in tax havens, for whom a 20% withholding tax applies.

In compliance with the EU Interest and Royalties Directive, withholding tax is not due on interest paid by companies resident in Italy for tax purposes or by permanent establishments in Italy of companies resident in the European Union to (i) resident companies, or (ii) permanent establishments of companies resident in other Member States of the European Union. In accordance with the Directive, the benefit is applicable if requirements concerning minimum holdings are fully met. The withholding tax rate may be reduced under any tax treaties Italy has concluded with various foreign countries.

In line with the provisions of the EU Directive on Interest and Royalties, the withholding tax on interest payments is not levied if these payments are made by Italian resident companies or by Italian permanent establishments of EU resident companies to affiliated (i) companies resident, for tax purposes, in another EU Member State or to (ii) permanent establishments of companies resident, for tax purposes, in another EU Member State. In line with the above-mentioned Directive, the benefit is applicable if certain shareholding requirements are satisfied.

- **Withholding tax on royalties** – Royalties paid to Italian resident corporations, or to Italian permanent establishments of non-resident corporations, are not subject to withholding tax. In principle, royalty payments to non-Italian residents are subject to a 30% final withholding tax. Under certain conditions, the tax base may receive a 25% flat deduction.

The withholding tax rate, if due, can be reduced under any tax treaties Italy has concluded with various foreign countries.

In line with the provisions of the EU Directive on Interest and Royalties, the withholding tax on royalty payments is not levied if these payments are made by Italian resident companies or by Italian permanent establishments of EU resident companies to (i) companies resident, for tax purposes, in another EU Member State or to (ii) permanent establishments of companies resident, for tax purposes, in another EU Member State. In line with the above-mentioned Directive the benefit is applicable if certain shareholding requirements are satisfied.

## • Tax treaties

In order to avoid double taxation, Italy has concluded tax treaties with the following Countries:

- Albania
- Algeria
- Argentina
- Australia
- Austria
- Bangladesh
- Belgium
- Brazil
- Bulgaria
- Canada
- China
- Cyprus
- Czechoslovakia
- Denmark
- Ecuador
- Egypt
- Estonia
- Finland
- France
- Georgia
- Germany
- Greece
- Hungary
- India
- Indonesia
- Ireland
- Israel
- Ivory Coast
- Japan
- Jugoslavia
- Kazakhstan
- Kuwait
- Lithuania
- Luxembourg
- Macedonia
- Malaysia
- Malta
- Mauritius
- Mexico
- Morocco
- Mozambique
- New Zealand
- Norway
- Oman
- Pakistan
- Philippines
- Poland
- Portugal
- Romania
- Russia
- Senegal
- Singapore
- South Africa
- South Korea
- Soviet Union
- Spain
- Sri Lanka
- Sweden
- Switzerland
- Tanzania
- Thailand
- The Netherlands
- Trinidad & Tobago
- Tunisia
- Turkey
- Ukraine
- United Arab Emirates
- United Kingdom
- U.S.A.
- Uzbekistan
- Venezuela
- Vietnam
- Zambia

The treaties generally provide more favourable tax treatment of Italian non-residents than the treatment provided under local Italian law. Most of these treaties are based on the OECD Model Convention.

## • EU Parent-Subsidiary Directive

Italy has fully implemented the EU Parent-Subsidiary Directive for the abolition of double taxation on corporate profits generated by an EU subsidiary, and distributed to an EU parent resident in another EU Member State.<sup>44</sup> According to the rules on taxation of dividends, dividends received by Italian parent corporations are 95% exempt from IRES regardless of the size of the underlying shareholding, and of the relevant holding period.

Dividends paid by Italian subsidiaries are exempt from withholding tax, provided that the EU parent corporations hold, for an interruptive period of one year, a direct shareholding of at least 25% in the Italian subsidiaries. Italy has not yet implemented the Directive 123/2003 regarding, amongst the other, the reduction of the relevant threshold to 20%.

<sup>44</sup> EU Directive No. 435/90.

## • EU Merger Directive

Italy has fully implemented the EU Merger Directive regarding the tax ramifications arising from mergers, divisions, transfers of assets and exchange of shares between EU-resident corporations.<sup>45</sup> In line with the EU Merger Directive, Italian tax law specifies the conditions under which income, profits and capital gains from the above indicated business reorganizations - occurring between Italian and other EU-resident corporations - are deferrable.

## • EU Directive on Interest and Royalty Payments

The EU Directive on Interest and Royalty Payments authorize provides for the abolishment of withholding tax on payments of certain interest and royalties between corporations resident in different EU Member States.<sup>46</sup> The benefit of the exemption from withholding tax on payments made in favour of EU beneficiaries is subject, amongst the others, to the following conditions:

- **The recipient is the beneficial owner of the interest and royalties payments. To this end, the recipient is regarded as the beneficial owner only if it receives the payment for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person**
- **The interest and royalties payments are made:**
  - By a company which directly holds at least 25 per cent of the voting rights in the ordinary shareholders meeting ("Voting Rights") of the company which receives the payment
  - To a company which directly holds at least 25 per cent of the Voting Rights in the company which makes the payments
  - To a company whose Voting Rights are directly held for a percentage not less than 25 per cent by a third company which also directly holds said minimum percentage in the company which makes the payments and in the company which receives the payments.
- **The minimum 25 per cent stake at point (ii) above is held without interruptions for at least 12 months.**

For the purposes of the exemption, the beneficial owner of the payments shall have to attest its residence through a certificate issued by the Tax Authorities of its State of residency.

<sup>45</sup> EU Directive No. 434/90.

<sup>46</sup> EU Directive No. 434/03. See also the implementing Legislative Decree No. 143/05.

The implementing Decree provides that the exemption is applicable on interest accrued or royalties payable as from January 1, 2004. In addition, the Legislative Decree introduces a withholding tax of 30% on payments made to non-Italian residents deriving from licences of industrial, commercial and scientific equipments.

## • Repatriation procedures and restrictions

Capitals, dividends, interests and royalties are freely transferable to and from Italy, and foreign citizens and business concerns are not subject to any restrictions on their repatriation. Transfers exceeding € 10,329.14 must however be notified to the Italian Foreign Exchange Office in accordance with the statutory regulations on money laundering.

## • Foreign Personnel

Foreign citizens can enter our territory for tourism, for study, for family reunification and in order to integrate into the labour market, within the limits established by entry flows.

### **ENTRY OF FOREIGN NATIONALS COMING FORM THE EUROPEAN UNION**

It is regulated by the Schengen agreements which made it possible to build a common area of free movement among the signatory States and eliminated border controls. In this case, the foreigner who holds a permit of residence, is exempt from a visa for stay not exceeding three months, upon the condition that he does not enter Italy for subordinate work, for self-employment or for apprenticeship.

### **ENTRY OF THIRD-COUNTRY NATIONALS**

The foreigner must hold a visa that authorizes his entry and that must be stucked on his passport or on another travel document. Some States are exempt from the obligation of visa for tourism. Visas are issued by Italian embassies and consulates in the country of origin or in the country in which the foreigner is regularly residing. The foreign national who legally enters Italy must apply for the permit of residence within eight working days. This document will bear the same reasons for stay as those stated in the visa.

## PURPOSE OF ENTRY AND VISAS

It is possible to legally enter and stay in Italy for:

- **Tourism** - in order to enter into our Country the foreign national must show a valid passport upon crossing the border. This kind of permit does not allow to perform a job
- **Study** - a visa for study can be applied for at the Italian Embassy in the foreigner's country of residence. Its validity is equivalent to the length of the course he/she intends to follow; in any case, it must not exceed one year
- **Work** - upon his entry into Italy, the foreign national must hold a visa for work that is issued keeping into account entry flows quotas established by decrees that are issued every year. Permits for work relate to subordinate work, self-employment and seasonal work.
- **Family reunification** - it is possible be granted this permit when the applicant is a regularly residing foreigner who holds a residence card or valid permit of residence for subordinate work, for self-employment, for asylum or for religious reasons: its duration must not shorter than one year

In order to establish a permanent, fixed-term or seasonal subordinate work relationship with a third-country national who resides abroad, the Italian or regularly residing foreign employer must submit a ad hoc request for authorization, bearing the name of the person, to the "Single Desk for Immigration" that is competent in the place where the job will be performed.

The foreign national who intends to carry out an industrial, professional, craftsmanship or commercial permanent self-employment job, or intends to establish a joint-stock or partnership company or to take up posts in a company must possess the moral and professional requirements that law requires from Italian citizens for performing their activities.

The foreign national who is already on the Italian territory for any other reason, on certain occasions and within the limits established, can perform a job activity by applying for the conversion of his title of residence to the competent local police headquarters (*Questura*). The holder of a permit of residence for study or training can perform:

- A subordinate job, once he has obtained the authorization from the competent Single Desk for Immigration and the conversion of his permit of residence
- A self-employment activity after the requirements for self-employment entry have been tested and after the permit of residence has been converted
- The holder of a permit of residence for seasonal work can perform permanent subordinate work, and having his permit of residence subsequently converted, only if the previous year he had got a permit of residence for seasonal work and, upon its expiration, he has gone back to his country of origin

# Italy | LABOUR LAW

Employment relationships are regulated by the Constitutional principles, the provisions of the Civil code, those of the so-called “Statute of Workers” (*Statuto dei Lavoratori*)<sup>47</sup> and by other statutory regulations.

Terms and conditions of employment are also periodically established by the so called Collectively Bargained Labour Agreements (CCNL) that have been entered for the different professional categories.

In case of conflict between the provisions of an employment contract and the provisions of law, those of law always prevail.

In addition, the Italian Constitution contains several general principles of labour law. Among these are Article 1 that states that “Italy is a democratic Republic founded on labour”, Article 4 that sets forth “the Republic recognises to every citizen the right to work”, Article 35 “the Republic protects work in all its forms and applications”. Some more specific constitutional principles of law, largely used by the Courts, are:

- **Article 36** - about fair remuneration, maximum working hours, weekly and annual paid vacation
- **Article 37** - about protection of women and minors on the job
- **Article 38** - about social insurance for old age, illness, invalidity, industrial diseases and accidents
- **Article 39** - on Freedom of Association
- **Article 40** - on the right to strike

Among the relevant statutory regulations, the Parliament passed on May 13th, 2014 a new statutory regulation, officially referred to as Act N° 78/2014, which amends some of the statutory regulations currently governing the Italian labour market. This new Job Act comes as a partial amendment to the Matteo Renzi’s Law Decree No. 34 which was enacted on March 20th, 2014.

## • The current types of employment relationship

There is no general requirement for an employment contract to be in writing. Statutory law sets forth that contracts of employment are deemed to be for an indefinite period of time, unless the statutory regulations provide otherwise.<sup>48</sup> The Job Act provides for fixed terms employment contracts. These contracts are subject to the following rules:

<sup>47</sup> Act No. 300/70.

<sup>48</sup> Act No. 230/62.



- The 20% Rule: Any company in Italy will only be able to have 20% of their workforce on fixed terms contracts
- Exempt from this regulation will be employers with under 5 staff members and those companies operating in the research field

If a company is over the 20% limit then:

- The company will be unable to hire new employees on fixed term contracts. (They will be able to once they are within the legal limits)
- There will be financial sanctions equivalent 20% of the salary for the 1st fixed time worker breaching the threshold, increasing to 50% of the salary for each additional breach. The sanction applies for each contractual month

The 20% limit number will be calculated from January 1st of the year the Fixed Term contract employees were taken on. Regarding renewal of Fixed Term contracts the following “5 x” rule applies: Fixed Term Contracts can only be extended 5 times within any given 36 month period including any renewals or extensions of contracts. Italian Employers will no longer be required to provide a technical, organizational and productive reasons for hiring staff with fixed term contracts or for renewing or extending them. With the new Labour Decree public and private companies operating in the scientific research field will be able to renew Fixed Term Employment Contracts on an indefinite basis – even beyond the 36 month period limit set for all other companies.

Women on fixed term contracts will be entitled to the same maternity leave rights as permanent female employees. In addition, women on fixed term contracts – who have taken maternity leave in the midst of their contract – will have their maternity leave counted as ‘working months’.

Regarding apprenticeship contracts, companies in Italy with more than 50 employees cannot have more than 20% of their workforce employed on apprenticeship contracts. A written training schedule is a requirement for all apprenticeship contracts.

## • Collective Bargaining Agreements

Unions can freely negotiate collective agreements at provincial, regional and national levels. Collective agreements and accords must be registered with the National Council of Economy and Labour – CNEL within 30 days after they have been entered by the parties.

The provisions of the collective agreements are binding for the employers of the category of workers falling into the agreement <sup>49</sup> and prevail over the employment agreement that the employer and the employee have entered, save for those contractual provisions more favourable to the employee.

The so-called economic agreements are instead those covering some categories of self-employed (i.e. commercial agents, some doctors working for the National Health Service, etc, also known as *lavoratori parasubordinati*).

Collective bargaining can regulate all aspects of the employer-employee relationship, except those that the law sets forth.

Collective agreements do not entitle the workers' representatives to any co-determination right, but only to the right to be informed and consulted about the most important decisions of the company.

## • Suspension of the employment contract

A provision of the Civil code <sup>50</sup> establishes the suspension of the employment relationship, occurring under the following circumstances:

- Industrial accident sustained by the worker
- Her/his illness
- Maternity of the worker (two months before and three months after childbirth).

Sick employees are entitled to retain their job position and seniority, as well as their salary for a period of up to six months or more, depending on their job category and the related applicable CCNL.

## • Discharge

A preliminary distinction must be made between fixed-term and indefinite term contracts. As far as fixed-term contracts are concerned, termination is automatic at the end of the specified duration or on completion of the specified task. <sup>51</sup>

<sup>49</sup> Act No. 936/86.

<sup>50</sup> Civil code, Article 2110.

<sup>51</sup> Act No. 230/62.

Nevertheless, according to the provisions of Civil Code, the employer may terminate the contract earlier for “just cause”.<sup>52</sup>

The Civil Code provides that each contracting party (the employer and the employee) of a contract of indefinite duration can terminate it, provided the notice period is respected, or without any notice in case of just cause.<sup>53</sup> According to domestic Law an employee can be dismissed for the following reasons:

- **Just cause (*Giusta Causa*) meaning a serious breach of the employee by her/his duties or other behaviour that prevents the working relationship to be carried forward**
- **Justified grounds (*Giustificato Motivo*) meaning with that either:**
  - A subjective reason that is a breach by the employee of his /her duties, which is not as substantial as to constitute Just Cause. The breach may consist, for instance, in failure to follow important instructions given by the management, material damages to machinery and equipment, low performance (the grounds for dismissal being “subjective reason”)
  - An objective reason whereby the employer needs to reorganize the manufacturing process or the workforce through redundancies.

Dismissals must always be in writing and detail the reasons for dismissal. Failure to do so makes the dismissal ineffective. Should the employee believe to have been unfairly dismissed, he/she can challenge the decision in court and the employer must observe the following rules:

If the company employs up to 60 workers in total throughout Italy, or up to 15 in a single working unit, the employer may chose between reinstating the dismissed employee or paying an indemnity (between two and half, and six months pay). Under all other circumstances, the employee is entitled to reinstatement and compensation for damages amounting to five months salary at least.

Failure to reinstate an unfairly dismissed employee usually results in an award of 15-month salary plus compensation for damages against the employer. Employees dismissed for reasons other than Just Cause are entitled to a notice period. Employers may exempt the employee from working during the notice period by paying

<sup>52</sup> Civil code, Article 2119.

<sup>53</sup> Civil code, Articles 2118 and 2119.

him/her an indemnity equal to the salary payable during the notice period. Such an indemnity is liable to social security charges.

Under the provisions of the “collective dismissal procedure”, whenever redundancy involves five employees at least within a 120 day period of time and an employer with fifteen or more employees, the company must preliminary consult with the trade unions. Termination without grounds is limited to trial periods, domestic workers, employees who have reached retirement age and directors.

Dismissals on the grounds of political opinion, trade union membership, sex, race, language or religious affiliation are null and void. Furthermore, members of workers’ committees may not be dismissed or transferred for one year following termination of their duties on the committee without the authorization of the relevant regional trade union organization. This provision applies to directors and domestic workers as well.

Dismissal on the grounds of pregnancy, if the dismissal takes place between the conception and the end of the female employee’s statutory period of absence on confinement leave or unpaid leave, until the child reaches one year of age, is also expressly prohibited.

Dismissal on the grounds of marriage is also prohibited. Protection against unfair dismissal of managerial employees is regulated by collective agreements.

In case of unjustified dismissal, remedies are different according to the size of the firm: employers having more than 15 employees (or five in the agricultural sector) in anyone establishment, branch, office or autonomous department, and employers having more than 60 workers, wherever located, are required to reinstate the dismissed employee, and to pay damages at a rate of not less than five monthly salary payments.

Alternatively, the employee can refuse reinstatement and request payment of damages equal to 15 monthly pay. If the employer invites the employee to return to work and the employee does not take up the offer within 30 days, the contract is automatically terminated.

Where there are fewer than 15 employees in a unit or fewer than 60 employees in total, the employee unfairly dismissed has no right to reinstatement, but is entitled to compensation ranging from 2, 5 to six times the monthly pay. The employees of charity, union or political organizations are not entitled to be reinstated (Law nr. 108/90).

The contract of employment may also be terminated by the resignation of the employee, provided a notice period is respected. However, an employee may resign with immediate effect in circumstances that Civil code Article 2119 specifies, like:

- Non-payment of wages or social security contributions
- Closure of the enterprise
- Failure to be included within the category or grade corresponding to the work effectively being undertaken
- Refusal to grant due holidays
- Unilateral changing of the employee's duties with a corresponding reduction in wages
- Offences by the employer against the duty to safeguard the physical and psychological well-being of the employee (Civil code, Article 2087).<sup>54</sup>

Specific provisions of statutory law<sup>55</sup> on collective dismissals, provides for special procedures of information and bargaining with unions before terminating contracts, and special indemnities for the employees that are to be made redundant, according to EU directives.

## • Severance pay (TFR)

For any termination of the contract of employment, on whatever ground, even for dismissal for just cause or resignation, the employee is entitled to receive from the employer a severance payment, which is usually referred to as "*TFR - Trattamento di Fine Rapporto*".

TFR is deemed to be a part of salary, must be set aside every year and kept by the employer, based on the formula of 7,5% of every year's salary, plus revaluation according to a composed index of 75% of price index increase + 1,5%.<sup>56</sup>

The TFR may be partially paid off in advance, upon occurrence of the following two conditions:

- The employee has reached eight years of service
- She/he intends to purchase her/his household's residence, or needs to withdraw the TFR for health care, extended leave for child care or educational leave.<sup>57</sup>

<sup>54</sup> Civil code, Article 2087.

<sup>55</sup> Act No. 223/91.

<sup>56</sup> Act No. 297/82.

<sup>57</sup> CAct No. 63/00.

## • Equality

The Italian Constitution <sup>58</sup> sets forth the principle of equality of all citizens before the law "without difference of sex, race, language, religion, and political views, personal and social position". Italy has also ratified the International Agreement of Economic, Social and Cultural Rights (New York, 16 December 1966). <sup>59</sup>

Statutory law also sets aside any agreement or action by the employer, constituting discrimination for reasons of sex, race, language, religion, political opinion. <sup>60</sup> Equality between men and women at work is specifically recognised and guaranteed by the Law. <sup>61</sup>

Other provisions of statutory law provide for affirmative action to encourage equal opportunity for women in accessing to employment and during employment. Dismissals for discriminatory grounds as such as political and union views, religion, participation in union activities are prohibited. <sup>62</sup>

Likewise, dismissals for discriminatory reasons, such as race, sex, language, political and union views, and religion are null and void and requires always the reinstatement of the dismissed worker. <sup>63</sup> Other kinds of discrimination as such as age discrimination, handicap discrimination and AIDS base discrimination are forbidden. <sup>64</sup>

A law on sexual harassment at work does not exist, though, there is case law on unfair dismissal based on this ground. The Constitutional Court has ruled that equality is a fundamental right of foreigners as well. For citizens of European Union member Countries, Article 48 of the EEC Treaty abolishes all discrimination at work, wage and other conditions of work. Law nr. 40/98 establishes equality between other foreign workers legally resident in Italy and Italian workers.

## • Social Security System

The "Cassa Integrazione Guadagni" is a State fund within the scope of the National Social Security Institute. It was established in 1954 <sup>65</sup>, with a view to protecting the workers' earnings in the event the enterprise has difficulties. The Italian social security, managed by INPS, is compulsory and provides comprehensive benefits for all employees.

<sup>58</sup> Italian Constitution, Article 3.

<sup>59</sup> Through the enactment of Act No. 88/77

<sup>60</sup> Act No. 300/70.

<sup>61</sup> Act No. 903/77.

<sup>62</sup> Acts No. 125/91 and 604/66.

<sup>63</sup> Act No. 108/90.

<sup>64</sup> Acts No. 104/92 and 135/90.

<sup>65</sup> Act No. 788/54.

The social security costs, which are calculated on gross earnings, are jointly financed by the contributions of employees and employer. Employers have to pay two-thirds of contributions and employees are responsible for the remaining third.

As far as wage compensation funds are concerned, domestic labour law sets forth special provisions for guaranteeing workers wages in case of a temporary lay-off or temporarily reduced company activity not attributable to the employer or to the employees or caused by the general economic situation.

A Wage Compensation Fund (“*CIG – Cassa Integrazione Guadagni*”) is available to industrial workers. The employer provides 80% of gross wage for hours not worked, and is subsequently reimbursed by INPS. An Extraordinary Wage Compensation Fund (“*CIGS - Cassa Integrazione Guadagni Straordinaria*”) helps to secure employment once production resumes in a restructured, reorganized or converted company.

Only companies employing 15 or more employees are eligible for CIGS. Compensation equals 80% of the worker’s gross wage for hours not worked, and is payable in a 12 month continuous period. The “*Cassa Integrazione Guadagni*” is mostly used in cases of suspension or temporary reduction of business activity of a company for reasons beyond market fluctuations and includes suspension of activity in the building industry due to weather damages.

## • Pension System

The Italian compulsory state pension system is financed by social contributions paid by the employer during one’s working life, and is based on actuarial fairness. The retirement age ranges between 62 and 66 years.

Starting from January 2013, retirement in the private sector is possible for workers after 20 years of contribution and at 66 years and 3 months of age for male workers. Employed female workers retirement age is currently 63 years and 3 months. It will be however 66 years and 3 months from 2018 on. It is possible to retire anyway, if 42 years and one month for males and 41 years and one month for females of social security contribution have been achieved.

The reform includes incentives for workers who decide to continue working, although currently eligible for a public pension. Such incentives provide for a compensation equal to 32.7% of the salary of the worker who has decided to continue working.

Integrative pension schemes in Italy are voluntary for workers and companies alike. The law guarantees freedom for individuals to subscribe to supplementary pension schemes, while leaving companies are free to choose whether to set up their own funds. Nearly all funds are based on a fixed contribution rate.

Regarding disbursement, beneficiaries can generally withdraw up to 50% as a lump sum then the entire or remaining amount as an annuity.

## • Severance pay scheme

In 2005 a new statutory regulation was enacted<sup>66</sup> to the purpose of redefining, starting from January 1, 2008 the entire statutory regulation applicable to supplementary pension schemes for employees of private companies.

- Increasing the amount of financing flows dedicated to supplementary pension schemes
- Monitoring of the management of the financial resources arising from the workers contribution
- New taxation regime applicable to pension funds
- Harmonization of the supervision system applicable to the entire supplementary pension sector
- New financing system though the contribution by the employee of its severance pay (so called "TFR").

Specifically, the statutory regulation provides that the employee is entitled to choose within a six months term, at his discretion, as whether:

- Leaving the accrued severance pay within the employing company
- Contributing it to a pension fund

If such six months period elapses without any election by the employee, the accrued severance pay shall be contributed by the employing company to the pension fund mentioned in the relevant labour agreement based on his/her implicit consent.

<sup>66</sup> Legislative Decree No. 252/05.



## • Types of ownership

Real estate law is governed mainly by the Italian Civil Code, and by special laws for specific issues. Real estate development projects and renovation works require approval by local authorities entailing administrative licenses and permits. Real estate assets may be:

- Part of a joint property (*'condominio'*). Specific provisions of the Italian Civil Code (ICC) apply to assets forming part of a co-property
- Part of a going concern. Rules relating to the transfer of a business apply.
- Stand alone assets

There are four titles for classifying real estate assets:

- Full ownership
- Long lease
- Lease of business
- Usufruct and Right of Common.

## • Land Registers

The databases of real estate registration in the Land Registers (Conservatoria dei Beni Immobiliari and Catasto) make available to the general public all the information regarding any real estate transaction. As a result, the information on the Registers is - by operation of the law – deemed to be known to all, making contractual rights so registered enforceable against any parties. Registration of a conveyance deed takes place at the Land Register of the province where the real estate property is located and regards the title and a short summary of the registered deed.

## • Transfer formalities

The agreements for purchasing or selling real estate properties, and creating or transferring real estate rights, must be in writing. These agreements are enforceable following registration with the local Land Register. A real estate sale in Italy is void unless the seller holds a valid administrative building concession for the property. Purchase contracts can be:

- Preliminary contracts
- Final contracts
- Forward sale agreements.

Preliminary contracts are the most common since both parties must fulfill certain conditions (eg, the satisfactory outcome of the necessary title searches) before entering into the final contract.

## • Construction

Recent Legislative Decree 20 June 2005 no. 122 has provided for a regulation aimed to protect purchasers of real estate under construction. Real estate under construction are deemed those buildings for which the construction permit has been released and whose building procedure is ongoing or those building whose construction procedure is at stage which does not enable the release of the fitness for use certificate. In particular the above mentioned Legislative Decree provides for:

- The obligation of the construction company to file a performance bond for an amount equal to the amount paid by the purchaser, the obligation for the construction company to deliver an insurance policy aimed to cover the purchaser from eventual risks for defects showed up following the execution of the purchase contract; specific provisions to be inserted in the purchase contract;
- A specific regulation for situations of financial crisis of the construction companies
- The creation of a fund aimed to provide the reimbursement of the purchasers which have suffered a loss upon bankruptcy of the construction company.

## • Leasehold types and formalities

### RESIDENTIAL AGREEMENTS

Specific provisions regulate residential rental agreements and apply to all properties except those seen as having historical, artistic, archaeological or ethnic significance. There are two general types of rental agreements:

In both cases, tenants may terminate their agreement at any time, but must give six-months prior written notice to their landlord. Clauses and agreements either indicating a term exceeding that set by law, or a rental rate higher than that declared in the written and registered rental agreement, or in the standard agreement, are null and void.

- Unregulated agreements: the parties can determine the rental rate and any periodic increase. These agreements run for four years, renewable, with some exceptions, for additional four-year terms
- Regulated agreements: these must comply with the standards terms and conditions, national and local, of standard agreements negotiated between landlords associations and the main tenants associations.

## RENTAL AGREEMENTS FOR COMMERCIAL PROPERTIES

Rental agreements for commercial properties follow separate specific rules. Commercial properties include those for industrial, commercial, tourist, business, workshop or similar use. Commercial rental agreements must be for a minimum term of six years, or nine years for hotels and similar businesses.

These are automatically renewed for another six, or nine-year term, unless either party gives the other twelve months, 18 months for hotels, prior written notice of its intention to leave. Also, a landlord can deny renewal upon expiration of the first contractual term if he/she needs to use the property:

- As his/her own domicile
- For productive activity carried out by himself/herself or by a close relative
- To carry out substantial restructuring of the property.

The rent is set by the parties, subject to any periodic increase required by law. If the landlord terminates the rental agreement other than for just cause, he/she must give the tenant compensation for the loss of goodwill, equaling 18 months rent, or 21 for hotels leases.

Compensation doubles if the landlord then rents out the same property within one year to someone in the same or a similar business as the original tenant. There is no right to compensation if the property is for:

- Businesses without direct contact with the general public
- Professional business or temporary activity
- Secondary properties in railway stations, ports, airports, highways, service areas, hotels and tourist resorts.

Any provisions or agreement limiting the contractual term set by law or introducing terms favoring the landlord in violation of the rent control (*equo canone*) law are null and void.

### • Real estate investment funds

The regulatory framework for real estate funds sets out:

- Terms and conditions for real estate assets contribution to closed-end real estate investment funds
- Terms of real estates assets contributions from, or sales of real estates assets to, managing company shareholders of the relevant fund, or companies affiliated with the managing company.

The investment fund can hold, at most, real estate of its managing group equaling 60% of the fund's aggregate value. It can take up loans amounting to 60% of the value of the real estate assets held. Also, it can hold interests in real estate companies active in construction.

## • Financing acquisition

Type of Acquisition Vehicle. The acquisition of real estate assets is through a special purpose vehicle. Limited liability companies (*S.r.l. - Società a responsabilità limitata*) are used especially for tax reasons. Security Package. A customary security package in a real estate acquisition would include:

- Pledge on the shares or quotas of the vehicle
- Mortgage for the acquired estate
- Pledge on the bank accounts of the company holding the estate
- Pledge on the VAT receivables for the tax authorities

Also, under Italian banking law, mortgages granted to secure mortgage loans are not subject to claw back action if mortgage registration takes place at least ten days before the bankruptcy declaration.

## • Financial Assistance Rules

Italian law prohibits financial assistance from a company to a buyer for the latter's acquisition or subscription of the company's shares. This applies to all types of limited liability companies, making it illegal to directly use the target's assets to finance the acquisition or to secure the loan received by the buyer. This provision remains in full force after the updating of Italian company law in 2004.

With the 2004 Company Law, merger-based leverage buy-out transactions are legal in Italy, subject to compliance with the Italian Civil Code. This applies to mergers between companies, one of which has incurred debt in order to purchase a controlling stake in the other, if, as a result of the merger, the latter's assets are an implicit guarantee or source for the repayment of the debt. Certain formalities apply when implementing a merger between an acquiring company that has incurred debt and the target company.

The merger plan must indicate the sources of funds available to the company after the merger for meeting its obligations. The directors must show that the surviving company has sufficient funds to repay the acquisition debt and file a business and financial plan giving details of such sources.

- **Due diligence checks**

Due diligence verifications in real estate transactions cover various items relating to: With the 2004 Company Law, merger-based leverage buy-out transactions are legal in Italy, subject to compliance with the Italian Civil Code. This applies to mergers between companies, one of which has incurred debt in order to purchase a controlling stake in the other, if, as a result of the merger, the latter's assets are an implicit guarantee or source for the repayment of the debt. Certain formalities apply when implementing a merger between an acquiring company that has incurred debt and the target company. The merger plan must indicate the sources of funds available to the company after the merger for meeting its obligations. The directors must show that the surviving company has sufficient funds to repay the acquisition debt and file a business and financial plan giving details of such sources.

#### **ENCUMBRANCES, RESTRICTIONS ON THE SELLER'S FREEDOM OF SALE**

Before purchasing real estate, prospective buyers should conduct an appropriate ownership (cadastral) search to ensure against encumbrances, in particular of mortgages or easements.

#### **ARCHAEOLOGICAL RESTRICTIONS**

Italy's Ministry of Culture<sup>1</sup> has a pre-emptive right to the sale or transfer of any real estate property in Italy with historical or archeological value or significance. Perspective purchaser of real estate properties with historical or archeological value or significance must notify the Ministry of any transfer or sale involving such properties. Statutes or contractual provisions may also establish such pre-emptive rights.

#### **TOWN PLANNING RESTRICTIONS**

Each Italian municipality decides the permitted use of real estate properties under its jurisdiction in keeping with local laws and regulations. Inter vivos (inherited) property deeds, involving partition of co-owned so-called *diritti reali* (rights enforceable against third parties), are null without a certificate from the local authorities stating the property's intended destination. The certificate is mandatory for establishing or transferring any real estate rights, irrespective of type or destination. It must mention the intended destination of the property in accordance with local area regulations. Any subsequent change in the destination or use of the property requires the local authorities' advance approval. The certificate provides any prospective buyer with information on the terms, conditions and limits applying to the property under sale.

## CONSTRUCTIONS PERMITS

These are required only for:

- Construction of new buildings
- Urban restructuring
- Restructuring works modifying the structure, size and/or use of a property.

Other real estate works do not require prior authorization if the relevant local authorities receive administrative notice.

## ENVIRONMENTAL ISSUES

Italian environmental regulations are for public safety. Some provisions relate to reclaiming polluted land or facilities. If pollution levels exceed the legal threshold, the owner or occupier of the polluted property or the party responsible for the pollution is liable.

He/she must bear all the costs necessary for reclaiming the area or implementing specific safety measures preventing future pollution. The reclamation process must respect administrative procedures and periodical reviews. Failure to implement the reclamation plan may result in fines and even criminal liability.

### • Disclaimer

While this chapter has endeavoured to go into length about the basic requirements imposed on companies in Italy by the current legislation, this is only intended to provide a glance at the legislation. Any business interested in setting up in Italy is advised to first consult legal and accounting professionals for individual advice and not rely on the content of this chapter.

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Lithuania

Strategum Dargis ir Partneriai



# Strategum Dargis ir Partneriai

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Lithuania

## General information

A professional association of business law advocates based in Lithuania.

Our main objective is to become a business partner and a strategist of a client and to ensure successful development of his business. Our team - professional advocates, lawyers, project managers are concerned with the Client and his needs; therefore, working with business companies, our uppermost focus is on innovative, operational and business-oriented, as well as economic logic-based solutions.

Main clients of "STRATEGUM Dargis ir partneriai" are Lithuanian and foreign companies, and consequently, the lawyers work and specialize exclusively in the field of business law disputes and their prevention.

### 📍 Head Office

A. Juozapavičiaus pr. 31-11,  
Kaunas 45257, Lithuania

☎ +370 698 30686

info@strategum.lt

<http://www.strategum.lt>

## Distinctive features

**We ensure professionalism** - specialize and work specifically in the field of business law; members of the team of the association constantly improve their qualification in the field of business law.

**We ensure fast response** - the Clients receive an answer to any question or request at least within one working day; the works are carried out in advance by agreed deadlines and conditions.

**We ensure simplicity and efficiency** - each Client communicates with his lawyer directly and immediately, with one contact person on all issues.

**We ensure feedback and clarity** - taking into account the specifics of business, the Clients receive responses and oral consultations offhand, and regular Clients are consulted free of charge immediately.

**We ensure a satisfactory system of payment for legal services** - the Client can choose a convenient payment method for legal services.

**A business-oriented approach ensures the professionalism, speed, reliability and feedback to our Clients.**

## Main fields

- Business contracts and Negotiations, Labour law, Company law
- Financial law, Intellectual law, IT law
- Construction outsourcing, Real Estate Law, Transport law, Bankruptcy law
- Public procurement law, Insurance law, Pre-trial and judicial debt recovery
- Cases with foreign element, Disputes of shareholders, Open seminars for business

## • Popular types of legal persons

If you have adopted a decision to start a business in Lithuania, firstly you need to decide what kind of company is the most suitable for achieving the goals. Having assessed the risk that you want to take, you can choose between limited or unlimited liability company. The following business-oriented enterprises are the most common in Lithuania:

- Public Limited Liability Company (AB)
- Private Limited Liability Company (UAB) (the most popular)
- Small Partnerships (MB)
- Individual Enterprise (II)
- Public Enterprise (VšĮ)

It is possible to set up the Closed Joint-Stock Company (UAB), the Public Enterprise (Public Institution), the Small Partnership (MB) and the Individual Enterprise (II) by submitting the necessary documents to the Lithuanian Registry manager electronically via the electronic customer self-service system of the Centre of Registers. The following table shows the essential differences between the legal forms of the listed legal persons:

Criteria for comparison	Small Partnerships (MB)	Private Limited Liability Company (UAB)	Public Limited Liability Company (AB)	Individual Enterprise (II)	State Enterprise (VšĮ)
Number of participants	From 1 to 10 members (natural persons only)	From 1 (number unlimited)	From 1 (number unlimited)	1 owner (natural person)	Number of partners is unlimited. Can be set up by the state, municipalities, natural persons and legal entities <sup>1</sup>
Size of minimum capital	Not defined. Contribution may be monetary and/or tangible assets <sup>2</sup>	2.500€	25.000€	No	Contributions of partners are not defined
Liability	Limited liability (the company is solely responsible by its assets)	Limited liability (the company is solely responsible by its assets)	Limited liability (the company is solely responsible by its assets)	Unlimited civil liability (the owner is responsible solely by his own assets)	Limited liability (the company is solely responsible by its assets)
Decision-making (voting) principle	Each member has one vote <sup>3</sup>	If all shares of UAB providing voting rights are of the same nominal value, each share grants one vote in the general meeting of shareholders	If all shares of UAB providing voting rights are of the same nominal value, each share grants one vote in the general meeting of shareholders	Decisions are taken by the owner	Partners make decisions by voting. 1 partner has 1 vote

<sup>1</sup> Article 4 of the SEL

<sup>2</sup> Clause 6, paragraph 4 of Art. 4 of LSME

<sup>3</sup> Paragraph 3 of Article 16 of LSE

<sup>4</sup> Art. 72 of LC

<sup>5</sup> Paragraph 1 of Article 51 of LC

## • Public limited liability company (AB)

A public limited liability company is a private legal entity with limited civil liability, which means that the company is liable only by its own assets in case of failure the business. The AB may be converted into a private limited liability company, state enterprise, municipal enterprise, agricultural company, co-operative company (cooperative), general partnership, limited partnership, individual enterprise, public establishment, small partnership <sup>4</sup>. Management bodies of AB are the general meeting of shareholders and manager of the company. A collegial supervisory body - the supervisory board and the collegial management body - the board may be formed.

### Advantages

- Unlimited number of founders
- Shareholders may receive profit by distributing dividends
- Better prospects for business development
- The most important decisions are taken by the shareholders by voting
- The capital of the company may be increased from the company's funds (retained profit) <sup>5</sup>
- The biggest advantage of AB is the opportunity to attract investors by selling shares by issuing new shares or debentures (shares can be traded on a stock exchange)

### Disadvantages

- Relatively big authorized capital
- Strictly controlled cash flows
- If the manager of the company is not a shareholder, his decision-making power is limited and directly depends on the decisions of the shareholders
- More complex bookkeeping and preparation of financial statements
- More complex procedure for reorganization and liquidation

## • Private Limited Liability Company (UAB)

Private Limited Liability Company (UAB) is a private legal entity with limited civil liability. This means that the shareholders are not liable by their assets for their unfulfilled obligations of the company. The authorized capital of UAB must be at least EUR 2 500. UAB may established by both one and more natural and/or legal persons, and the number of shareholders is unlimited. A shareholder may sell or otherwise transfer (for example, donate, exchange, etc.) his own shares of UAB. UAB can be transformed into public limited liability company, state enterprise, municipality enterprise, agricultural company, co-operative company (cooperative), general partnership, limited partnership, individual enterprise, public establishment, small partnership <sup>6</sup>.

<sup>1</sup> Article 72 of LC

<sup>2</sup> Paragraph 2 of Art. 5 of LCT

The most important decisions are taken by shareholders by voting. Each share grants one vote; therefore, the person who acquired the majority of shares has the greatest influence during the voting at the general meeting of shareholders. UAB may be a sole management body – a manager, and a collegial management body – may be formed as well.

#### Advantages

- In the event of a failure of business, the shareholder risks only by the assets that he has contributed to UAB, thus protecting his personal assets
- Tax relief for UAB: if the average number of employees does not exceed 10 people and the income tax period does not exceed EUR 300 000, a reduced tax rate of 5% is imposed instead of the usual 15% rate<sup>7</sup>
- In order to attract additional funds, UAB may issue new shares for which the shareholders pay a fixed amount of money
- Ability to withdraw from business by transferring shares of UAB to other persons or selling business

#### Disadvantages

- During establishment of UAB, it is obligatory to contribute at least EUR 2 500 for the authorized capital
- Shareholders can earn the UAB profit only through dividends (if the company is operating profitably), or by receiving remuneration, but in this case, it will be necessary to pay big taxes
- Non-public trading in shares. A shareholder intending to sell shares or UAB having issued new shares must first offer shares to other shareholders of UAB

## • Small Partnership (MB)

The small partnership is a private legal entity with limited civil liability. This means that members are not liable by their assets for their unfulfilled obligations of small partnership. A small partnership can be established by up to 10 natural persons (there may be one founder). A small partnership can carry out any activities not prohibited by laws.

Although the it is not required to have a minimum authorized capital in small partnership, the members of the small partnership shall pay contributions (their size and payment procedure are determined at the meeting of members), while the profit of the small community is distributed in proportion to the amount of the member's contribution (other types of profit distribution can be provided for as well).

#### Disadvantages

- Only a natural person may be the founder/member; in total not more than 10 (for comparison, both natural and legal persons may be the shareholder of UAB, and the number of shareholders is not limited)
- Since there is no clear procedure for voting and distribution of profits, there may be disputes between members of the small partnership
- Bookkeeping of small partnership is only simpler in some cases than UAB (for example, if the small partnership does not have employees, or it is not a VAT payer)

#### Advantages

- Limited liability of members, i.e. if the business fails, the members risk only by their own contribution, thereby protecting their personal assets (for comparison, the owner is liable by his personal assets for unfulfilled liabilities of the company)
- The minimum authorized capital requirement is not applied (for comparison - the minimum authorized capital of the company is EUR 2 500)
- Possibility of withdrawing voluntarily from the business, i.e. a member of the small partnership may withdraw from the partnership by reclaiming his contribution; he may also sell or otherwise transfer the rights of a member to other persons

## • Public Enterprise (VšĮ)

Public enterprise (VšĮ) is a non-profit public limited liability company with the objective of satisfying public interests through the socially useful activities. Public enterprise may be set up by one or more natural and/or legal persons; the number of founders is unlimited.

### Advantages

- Limited civil liability - the partner risks only by the assets that he contributed to the public enterprise, thereby protecting his personal assets
- The public enterprise can receive support from legal entities and support from the population
- Certain tax reliefs
- The public enterprise may carry out commercial activities
- Possibility to withdraw from the activity by transferring the partner's rights to other persons
- Possibility to attract additional funds by admitting new partners to the public enterprise
- There is no need to contribute to the authorized capital (for comparison, the minimum authorized capital of UAB is EUR 2500)

### Disadvantages

- Profit of public enterprise cannot be paid to the partners; therefore, the partners can receive money from the enterprise only through the payment of remuneration
- The enterprise cannot be reorganized into UAB. The public enterprise can be converted into a budgetary institution, charity and support fund<sup>8</sup>
- The public enterprise may engage only in the activities specified in its articles of association

## • Individual Enterprise (ĮĮ)

An individual enterprise (ĮĮ) is a private legal entity of unlimited liability. This means that the owner of the individual enterprise (ĮĮ) is liable for the non-fulfilment of obligations by his own personal assets. Only one natural person who cannot be the owner of another ĮĮ can be the founder and owner of the individual enterprise (ĮĮ). Establishment of an individual enterprise (ĮĮ) is recommended if the business is individual and intended for one person, and

<sup>8</sup> Article 16 of LSE

the chosen type of activity is not risky. If the business fails, the owner of the individual enterprise (IJ) will be liable personally for nonfulfillment of IJ obligations. As the laws do not require a minimum initial capital, a business can be started having a good idea and small initial funds.

#### Advantages

- There is no need to contribute to the authorized capital (for comparison, the minimum authorized capital of UAB is EUR 2 500)
- The enterprise can be transformed into UAB
- Easy to take profit: The owner of the individual enterprise (IJ) can take the individual enterprise's money or other assets for his personal needs at any time (it cannot be done by UAB)
- The owner can work alone in his enterprise without entering into employment contract, and therefore he shall pay lower taxes. Other people can be recruited, if necessary

#### Disadvantages

- If a business is loss-making, the individual enterprise (IJ) may go bankrupt, but the owner is liable for nonfulfillment of obligations by his own assets
- Only one person may be the owner of the individual enterprise (IJ); he cannot establish an individual enterprise (IJ) with any partners
- It is not possible to issue new shares, thus attracting funds
- The accounting of private enterprise is, in many cases, simpler compared to UAB.

## • Centre of Registers

The Centre of Registers is a state-owned enterprise for the administration of various state registers, including the Register of Legal Entities (JAR). The Centre of Registers administers/manages the Real Property Register and Cadastre, the Mortgage Register, the Address Register, the Population Register, the Register of Legal Entities, the register of Contracts, the Register of Power of Attorneys, the Register of Property Seizure Acts, the Register of Marriage Contracts, the Register of Legally Incapable Persons or Persons With Limited Legal Capacity and the Register of Wills.

Each legal entity in Lithuania has a unique number provided by the Centre of Registers, which is given during the registration of a legal entity. JAR collects, stores and processes the data and documents related to legal entities, for example, establishment documents of legal entity, articles of association, shareholders' decisions, etc. The data of the Register of Legal Entities, the documents accumulated in the Register and any other information submitted to the Register are public and provided in accordance with the procedure established by laws and other legal acts <sup>9</sup>.

The Register of Legal Entities participates in the activities of and is a member of the interconnection systems of central, commercial and company registers of the Member States of the European Union and the countries of the European Economic Area, established in accordance with Directive 2009/101/EC of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent (OJ 2009 L 258, p. 11), as last amended in paragraph 2 of Article 4a of Directive 2012/17/EU of 13 June 2012 of the European Parliament and of the Council (OJ 2012 L 156, p. 1).

The system of interconnection between the central, commercial and company registries of the Member States of the European Union and the countries of the European Economic Area comprises central, commercial and company registries of the Member States of the European Union and the countries of the European Economic Area, the European Central Bank and the European e-Justice Portal <sup>9</sup>.

## • Value Added Tax (VAT) payers

Value Added Tax (VAT) is the consumption tax paid by the end user. This is an indirect tax payable at each stage of the distribution of the product or service or production process. It is collected to the state budget depending on the value-added created. VAT payers are Lithuanian and foreign natural and legal persons who carry out any type of economic activity in Lithuania, as well as an entity of collective investment established in the Republic of Lithuania without status of legal entity, the form of activity of which is an investment fund.

A special scheme for small companies is implemented in Lithuania. The taxable person of the Republic of Lithuania must not submit an application for his registration as a VAT payer if the total amount of remuneration paid for products and/or services rendered during the year during the last 12 months did not exceed EUR 45 000 <sup>10</sup>. For a small company (depending on the type of activity) that mainly works with non-VAT payers and/or natural persons, in most cases, it is preferable not to become a VAT payer, since VAT is not calculated when issuing invoices to customers, thus the final price of products and/or services to a customer who is not VAT payer becomes more attractive.

<sup>9</sup> Article 4 of LRLE

<sup>10</sup> Art. 4 prim of LRLE

<sup>11</sup> Paragraph 2 of Article 71 of LVAT

It should be emphasized that if the value of the products purchased by the taxable person of the Republic of Lithuania from other Member States exceeded EUR 14 000 in the previous calendar year, or if this threshold is foreseen in the current calendar year, then the taxable person must submit an application for his registration as a VAT payer, even when the annual remuneration is 45 EUR 000 was not exceeded <sup>12</sup>. A VAT payer can also become a voluntarily if his volume of activities is within the established limits.

## • VAT Rates

**Standard VAT rate is 21 %.**

**The reduced rate of VAT of 9% is applied to <sup>13</sup>:**

- Books and non-periodical newsletters (including textbooks, exercise books, encyclopaedias, dictionaries, manuals, information brochures, albums of photographs and reproductions, children books with pictures, drawing and colouring books, printed or manuscript sheet music, maps, diagrams and drawings, except for calendars, notebooks and other publications of a similar nature)
- Periodical publications, with the exception of publications publishing eroticism and violence, or the publications noncompliant with professional ethics, and except for the publications in which paid advertising amounts to more than 4/5 of the total publication area)
- Passenger and passenger luggage transport services by regular routes (determined by the Ministry of Transport and Communications (authorized by it) or by the municipality)
- Accommodation at hotels and other special accommodation services supplied according to the procedure laid down in the legal acts regulating tourist activities

**The reduced rate of VAT of 5% is applied to <sup>14</sup>:**

- Pharmaceuticals and medical aid measures, where the costs of acquiring these goods are reimbursed fully or partially in accordance with the procedure established by the Law on Health Insurance of the Republic of Lithuania, as well as non-compensated prescription medicines the taxable value of which exceeds EUR 300
- Technical support means for the disabled and repairs thereof
- Insurance services
- Radio and television
- Financial (investment) services.
- Sale or lease of property immovable by its nature

**Zero-rate of VAT is applied to:**

- Goods and services that are sold and shipped out of the EU
- Goods or services sold to another EU country

**Exempt from VAT <sup>15</sup>:**

- Goods and Services Related to Health Care
- Social Services
- Education and Training Services.
- Cultural and sports services supplied by non-profit making legal persons

<sup>12</sup> Article 7<sup>1</sup> of LVAT

<sup>13</sup> Article 19 of LVAT

<sup>14</sup> Article 19 of LVAT

<sup>15</sup> Art. 20-32 of LVAT



## • Restructuring of a legal entity

Restructuring of an enterprise is the procedure aimed at maintaining and developing the activities of an enterprise, settling its debts and averting bankruptcy through securing assistance of the creditors of the enterprise and application of economic, technical, organisational and other measures. The duration of the restructuring of an enterprise is defined in the restructuring plan. In many cases, legal entities try to use the restructuring institute to avoid bankruptcy proceedings. Restructuring may be initiated where <sup>16</sup>:

- An enterprise is in financial difficulties or there is a real possibility that it will be in financial difficulties within the next three months
- An enterprise was established at least three years before the date of filing of a petition to initiate enterprise restructuring proceedings
- An enterprise has not discontinued its activities
- An enterprise is not in bankruptcy or has not gone bankrupt
- At least five years have passed from the coming into effect of the court decision to close the enterprise restructuring proceedings, or the court ruling to terminate the proceedings (when all the creditors waive their claims and the court confirms their waivers, or the restructuring enterprise has met all the requirements of the creditors earlier than it was set out in the restructuring plan, and the restructuring administrator has provided evidence to the court)

The management body of the enterprise that meets the above criteria and wishes to start restructuring must prepare the guidelines of the plan for the restructuring of enterprise, which is approved by the meeting of the participants of the enterprise, the owner or the institution implementing the rights and duties of the owner, the state or municipal enterprise.

The guidelines of the restructuring plan is a document that describes the principles for the restructuring of the enterprise. The guidelines should clearly describe how the enterprise intends to restore its solvency. The guidelines shall be prepared by the manager of the company, but due to the specifics of the process, he needs a consultation of specialists. The content of the guidelines is strictly regulated by the Law on Restructuring of Enterprises. Additional documents must also be prepa-

<sup>16</sup> Art. 4 of LRE

red in accordance with certain rules and forms; the legal knowledge is necessary for the collection and preparation of the information. Amendments to the Law on Restructuring of Enterprises have empowered the court to adopt decision on the future destiny of the enterprise, and therefore the preparation of guidelines and submission of documents has become a more legal procedure, which requires specific knowledge and practice. The guidelines specify <sup>17</sup>:

- A short description of the current situation of the enterprise (the nature of activities, assets held and number of employees)
- Suretyship, guarantees and other measures of securing the discharge of obligations which the enterprise has granted to third parties (with indication of the third parties and persons to whom credits have been granted by third parties; in case of a natural person – the name, surname and address of the place of residence; in case of a legal person – the name, code and address of the registered office and/or place of operations; the amounts of credits granted to third parties and the amounts of suretyship, guarantees and other measures of securing the discharge of obligations)
- Information relating to the cases in which financial claims have been entered against the enterprise;
- A preliminary business plan of the enterprise, providing for the measures specified in paragraph 2 of Article 12 of this Law;
- Reasons behind the financial difficulties of the enterprise
- A list of creditors indicating: where the creditor is a natural person – the name, surname and address of the place of residence of the creditor; where the creditor is a legal person – the name and address of the registered office and/or place of operations; the amounts of claims, the time limits for the settlement thereof and measures of securing thereof
- Voluntary commitments of the enterprise to pay interest to creditors for the period from the date of coming into effect of the court ruling to initiate restructuring proceedings to the date of coming into effect of the court ruling to approve the enterprise restructuring plan (hereinafter referred to as the "restructuring plan");
- An estimate of administrative expenses, including the amount of remuneration for the restructuring administrator, for the period from the date of coming into effect of the court ruling to initiate the enterprise restructuring proceedings to the date of coming into effect of the court ruling to approve the restructuring plan.

An application regarding the initiation of restructuring proceedings in respect of the enterprise shall be submitted to the regional court where the registered office of the enterprise is located in accordance with the procedure established

<sup>17</sup> Art. 5 of LRE

by the Code of Civil Procedure of the Republic of Lithuania. An enterprise shall acquire the status of an enterprise under restructuring from the coming into effect of the court ruling to initiate the enterprise restructuring proceedings.

The court shall adopt a ruling to refuse to initiate the enterprise restructuring proceedings where <sup>18</sup>:

- An enterprise is in financial difficulties or there is a real possibility that it will be in financial difficulties within the next three months
- An enterprise has not discontinued its activities
- An enterprise is not in bankruptcy or has not gone bankrupt
- In the course of the examination of the application, the court makes a reasoned conclusion that the enterprise is insolvent. Since both restructuring and bankruptcy are means for resolving the solvency problem of the enterprise, the court, when deciding on the initiation of restructuring proceedings, has to assess not only the financial documents submitted by the enterprise, but also the activities thereof on the market, other data related to the activities carried out (whether the enterprise is capable of continuing its activities).

## • Termination of Legal Entity

### REORGANIZATION

Reorganization is one of the ways of termination of legal entity (LE), but the LE is not being liquidated up during the reorganization. The main objective of this procedure is the reorganization of business processes in order to increase the efficiency of the activities of the enterprise. Decisions on reorganization are usually taken where reduction of costs related to the management of one or more enterprises, administration costs, simplification of the management of several companies, etc. is necessary. The LE may be reorganized or participate in the reorganization only when its authorized capital is fully paid (the price of the last issue of shares). Only companies of the same legal form may undergo the reorganization <sup>19</sup>.

The LE may be reorganized by way of merger and split-off. Possible modes for merger of LE are as follows <sup>20</sup>:

- Merger by acquisition is the merger of one or more LEs to another already operating LE, to which all rights and obligations of reorganized LE are transferred
- Merger by the formation of a new company is the merger of two or more LEs into the new LE, to which all rights and obligations of the reorganized LEs are transferred

<sup>18</sup> Paragraph 5 of Art. 7 of LRE

<sup>19</sup> Art. 61 of LC

The possible ways for division of LE are as follows:

- Division by acquisition is the distribution of rights and obligations of the reorganized LE to other already operating LEs
- Division by the formation of a new company is the establishment of one reorganized LE based on two or more new LEs, who are transferred certain parts of the rights and obligations of the reorganized LE

Only the LEs of same legal form can usually undergo the reorganization. In order to reorganize the LEs of different legal form, some of them (one or several) may need to be reorganized into LE of other legal form before the reorganization.

The decision on the reorganization of the LE shall be taken by not less than 2/3 of votes. The decision is made by the general meeting of shareholders.

In the case of merger, the decision on reorganization may be taken by the LE, to which another LE is merged if the conditions laid down in the law are met.

The reorganization by merging or dividing creates new LEs. This is especially important in cases of licensed activities, as the newly created LE will have to obtain all necessary permits for its operation, regardless of whether the previously existed LEs had them.

The tax obligation of reorganized LE must be performed by the successor of its rights and duties. He shall be transferred the obligation to cover all unpaid amounts of reorganized LE tax and related payments (including those discovered after reorganization).

The manager of the enterprise under reorganization and participating in reorganization must notify the Register of Legal Entities, shareholders, managers of other companies undergoing the reorganization and participating in the reorganization of material changes in assets, rights and obligations during the period from drawing up the terms of reorganisation of a company to the general meeting of shareholders, whose agenda provides for the adoption of decision on the reorganization of the company.

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<sup>20</sup> Art. 63 of LC

If the terms of the reorganization were concluded in 6 months after the end of the financial year of either company participating in the reorganization, an interim financial report shall be prepared and submitted to the shareholders. It must not be concluded not earlier than 3 months before drawing up the terms of reorganization. In the event of division, interim financial statements are not prepared if all shareholders of each of the companies under the reorganization and participating in the reorganization by means of division agree with this.

At the end of the reorganization, it is necessary to re-register the assets of the reorganized LE (real estate, cars, trademarks, etc.)

The name of the reorganized LE may be used by the LE operating after the reorganization.

## **BANKRUPTCY**

Bankruptcy is the state of an insolvent enterprise where bankruptcy proceedings have been initiated against the enterprise in court or the creditors are performing extrajudicial bankruptcy procedures in the enterprise. Main purpose of the bankruptcy process is to satisfy the requirements of the creditors of a bankrupt company.

Bankruptcy proceedings against an enterprise are usually initiated due to its insolvency. Insolvency of an enterprise is the state of an enterprise when it fails to discharge its obligations (pay debts, carry out works paid for in advance, etc.) and the overdue liabilities of the enterprise (debts, unperformed works, etc.) are in excess of half of the value of the assets entered in the enterprise's balance. Thus, by will of the legislator, the insolvency of the enterprise, which constitutes the legal basis for opening a bankruptcy case, is assessed based on external (noncompliance with obligations) and internal (negative ratio of the assets and liabilities of the company) insolvency characteristics <sup>21</sup>.

When the overdue liabilities of an enterprise to third parties (debts) reach half the value of the assets entered in the balance sheet of the enterprise, the manager of the company is obliged to apply to the court relating to initiation of bankruptcy proceedings against the enterprise. The bankruptcy proceedings against the enterprise can also be initiated by the creditor of the enterprise if the enterprise fails to settle with the creditor within 30 days after the respective notification is served. The bankruptcy proceedings may also be initiated by the tax administrator.

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<sup>21</sup> Paragraph 8 of Art. of LEB

Proceedings shall be initiated if at least one of the following conditions exists:

- The enterprise is insolvent or the enterprise is late with payment of remuneration and amounts relating to employment relations to the employee (employees)<sup>22</sup>
- The enterprise has publicly announced to or notified the creditor (creditors) in any other manner of its inability or lack of intent to discharge its obligations<sup>23</sup>

The court shall refuse to initiate bankruptcy proceedings where<sup>24</sup>:

- Prior to adoption by the court of the ruling to initiate bankruptcy proceedings, the enterprise satisfies the claims of the creditor (creditors) who filed with the court a petition for the initiation of bankruptcy proceedings
- Restructuring proceedings have been initiated against the enterprise
- During the examination of the petition for the initiation of bankruptcy proceedings the court makes a sufficiently justified assumption that the enterprise has no assets or that its assets are insufficient to cover the legal and administrative expenses

The court, having adopted the ruling to institute a bankruptcy proceeding against the enterprise, shall appoint a bankruptcy administrator who, together with the meeting of creditors, shall decide on the division of the assets of the bankrupt enterprise and the liquidation thereof.

Bankruptcy proceedings may also be subject to extrajudicial bankruptcy procedures if the bankrupt enterprise is not sued in the courts where the material claims are laid against the enterprise, including claims related to employment relationships, as well as if the company is not subject to recovery based on orders for enforcement issued by courts or other institutions. In the course of the bankruptcy process by extrajudicial proceedings, the issues assigned to the jurisdiction of the court shall be resolved by a meeting of creditors. In fact, in case of extrajudicial bankruptcy proceedings, a bankrupt enterprise “makes peace” with its creditors, which often relieve the enterprise of debt repayment.

The meeting of creditors is a kind of self-governing body of creditors dealing with issues related to the bankruptcy process. The Law on Enterprise Bankruptcy consigns the meeting of creditors to consider the essential issues related to the activities of a bankrupt company. The bankruptcy process seeks to meet the

<sup>22</sup> Clause 1, paragraph 7 of Art. 9 of LEB

<sup>23</sup> Clause 2, paragraph 7 of Art. 9 of LEB

<sup>24</sup> Paragraph 3 of Art. 10 of LEB

financial requirements and interests of not only individual creditors, but also all of them. As a result, bankruptcy proceedings are not carried out by individual creditors, but by their whole (a meeting of creditors or a committee of creditors, if any is formed). Only the whole of creditors considers such issues related to the activities of the bankrupt enterprise as the control of the administrator's activity, the economic-commercial activity of the bankrupt enterprise, the liquidation of the enterprise, the procedure for the valuation of the assets to be sold, the approval of the sale price of the assets<sup>25</sup>. The right of creditors as a whole to consider the matters related to a bankrupt enterprise is an expression of the principle of creditors' autonomy. This right is exercised by a majority of votes of creditors when adopting decisions at the meeting of creditors<sup>26</sup>.

### **FRAUDULENT BANKRUPTCY**

The fraudulent bankruptcy is deliberate bringing of the enterprise to bankruptcy through deliberate mismanagement of the enterprise (action, inaction) and/or transactions, when it was known or should have been known that such transactions violate the rights and/or legitimate interests of creditors.

The acknowledgement of the bankruptcy of the enterprise as deliberate creates consequences for the persons responsible for bringing the enterprise to bankruptcy. When the enterprise is no longer able to settle with its creditors and is subject to bankruptcy proceedings and the assets of the enterprise are insufficient to satisfy the claims of the creditors approved by the court, and it is established that the assets are not sufficient due to the violation of the obligations (including fiduciary) established by legal acts and documents by the management bodies of the enterprise, in such case the management bodies of the enterprise shall have to compensate the damage caused to the enterprise, which consists of the claims or part thereof of dissatisfied creditors. Damage to creditors is considered a derivative of the damage caused to the enterprise.

Where the bankruptcy of the enterprise is acknowledged as deliberate, the limited liability of a legal person is terminated and the persons having intentionally brought the enterprise to bankruptcy shall be obliged to compensate the creditors of the bankrupt enterprise for damage manifesting by the amount of uncovered financial claims after the completion of the bankruptcy procedures of the enterprise. The persons having deliberately brought the enterprise to bankruptcy are also subject to criminal proceedings.

<sup>25</sup> Article 23 of LEB

<sup>26</sup> Article 24 of LEB

## LIQUIDATION OF A LEGAL ENTITY

Liquidation of an enterprise is the termination of the activities of a legal entity by removing it from the Register of Legal Entities. The legal entity is being liquidated upon completion of its bankruptcy proceedings. The liquidation of a legal person can also be performed involuntary (voluntarily).

The general meeting of shareholders of the enterprise adopts a decision on the liquidation of the LE by the majority of not less than  $2/3$  of votes. Such a decision may be revoked by the same majority of votes. A decision on liquidation of LE cannot be revoked if at least one shareholder has received part of the liquidated assets of LE. Liquidated LE may only enter into the transactions that are related to the termination of LE's activities or which are provided for in the decision on the liquidation of LE. The general meeting of shareholders cannot adopt a decision to liquidate the insolvent LE. In this case, the bankruptcy procedure applies. The LE receives the status of the liquidated LE from the date of the adoption of the decision to liquidate the LE by the general meeting of shareholders, and the documents of the liquidated LE, which are used by him in relations with other persons, must indicate its legal status "under liquidation". If any legal disputes arise in relation to the payment of debts, the LE assets cannot be distributed to shareholders until the court resolves these disputes and the settlement with the creditors is done. For the execution of the procedures related to the liquidation of the enterprise, the general meeting of shareholders shall appoint the liquidator of the company. The liquidator is a natural person (usually a manager of an enterprise) who performs all liquidation procedures until the LE is removed from the Register of Legal Entities. A liquidator may be a manager, shareholder, employee or other person of the liquidated enterprise. He shall be appointed and recalled by the shareholders by a simple majority of votes. The enterprise under liquidation must settle with all its creditors. First of all, the claims of creditors secured by mortgage of the assets of the liquidated LE are satisfied. Subsequently, the requirements are satisfied in the following order:

- Firstly, the claims of employees (wages, compensations, severance pays) are satisfied; claims for damages due to injury or death due to an accident at work
- Secondly, the requirements related to taxes, social and health insurance premiums are fulfilled
- Thirdly, all remaining claims of creditors are satisfied

The remaining assets of the liquidated LE are distributed to shareholders in proportion to the nominal value of their shares. These assets are taxed in accordance with the procedures set by laws. If litigation arises due to debts, the assets of LE may not be distributed to the shareholders until the court resolves these disputes and the settlement with creditors is done.



## • System of tax legislation of The Republic of Lithuania

The fundamentals of the system of tax legislation are enshrined in the Constitution of the Republic of Lithuania, where paragraph 3 of Article 127 thereof establishes that taxes, other payments to the budgets, and levies shall be established by the laws of the Republic of Lithuania. In accordance with Paragraph 15 of Article 67 of the Constitution, the Seimas of the Republic of Lithuania shall establish state taxes and other compulsory payments. The system of tax legislation shall comprise tax laws and subordinate legal acts adopted on their basis <sup>1</sup>.

The most important part of the system of Lithuanian tax legislation comprises the national legislation, in particular, the laws establishing taxes: for example, the Law on Corporate Income Tax of the Republic of Lithuania (hereinafter referred to as LCIT LR), the Law on Income Tax of Individuals of the Republic of Lithuania (hereinafter referred to as the LITI LR), the Law on Value Added Tax (hereinafter referred to as the LVAT LR), the Law on Real Estate Tax of the Republic of Lithuania (hereinafter referred to as the LRET LR), the Law on Land Tax of the Republic of Lithuania (hereinafter referred to as the LLT LR), etc.

The Law on Tax Administration of the Republic of Lithuania (hereinafter referred to as LTA LR), which establishes the basic concepts and regulations which must be observed in implementing the tax laws of the Republic of Lithuania, the basic principles of legal regulation of taxation, the list of taxes applied in the Republic of Lithuania, the functions, rights and obligations of the tax administrator, the rights and obligations of the taxpayer, the calculation and payment of taxes, the procedure of enforced recovery of taxes and related amounts as well as the procedure for the settlement of tax disputes <sup>2</sup> also falls within the legal system under consideration.

The tax administration procedures provided for in the Law on Tax Administration shall be applied in respect of all specified taxes and the taxpayers thereof, unless this Law or the relevant tax law provide otherwise <sup>3</sup>. 2004 Following the accession of Lithuania to the European Union in 2004, the law in force of the latter (acquis communautaire) has become part of our national legal system. Customs (and some issues related to the administration of import duties and VAT) are attributed to the

<sup>1</sup> Paragraph 1 of Article 3 of the Law on Tax Administration of the Republic of Lithuania

<sup>2</sup> Paragraph 1 of Article 1 of LR

<sup>3</sup> Paragraph 1 of Article 14 of LTA LR

exclusive competence of the European Union (paragraph 1 of Article 2, paragraph 1 of Article 3 of the Treaty on the Functioning of the European Union). These taxes are established and administered directly by the legislation adopted by the legislative bodies of the Union, inter alia Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code (hereinafter referred to as the Community Customs Code), Commission Regulation (EEC) No 2454/93 of 2 July 1993 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code. The competence of the Member States (including Lithuania) in this area is usually confined to individual or individual issues related to the administration of the said tax obligations, and national law only applies only to the extent that they do not contravene the Community customs legislation *acquis* <sup>4</sup>.

The main taxes in Lithuania – value added tax, corporate income tax, personal income tax, excise taxes – are administered by the State Tax Inspectorate (hereinafter referred to as STI). Structurally, the State Tax Inspectorate consists of: 1) the STI under the Ministry of Finance – the central tax administrator, and 2) the territorial STI – the local tax administrators subordinate and accountable to the central tax administrator. STI under the Ministry of Finance implements the tax administration policy in Lithuania, ensures payment of taxes to the budget, coordinates, controls and manages the work of territorial branches of STI, adopts legislation implementing tax laws.

Territorial STI implement tax laws, tax administration priorities, procedures, ensure proper payment of taxes to the budget, and enforce recovery of tax arrears. Tax disputes between the taxpayer and the tax administrator are dealt with by the central tax administrator, the Commission on Tax Disputes under the Government of the Republic of Lithuania and the court.

Hereinafter, this article discusses the main taxes of the Republic of Lithuania, i.e. corporate income, personal income, value added, real estate and land taxes. Also, compulsory health insurance and state social insurance contributions and contributions to the Guarantee Fund.

## • Corporate income tax

Corporate income tax in Lithuania is paid by entities complying with the status of legal entities – taxable entities, i.e. Lithuanian and foreign entities <sup>5</sup>.

<sup>4</sup> Paragraph 6 of Article 14 of LTA LR

<sup>5</sup> Paragraph 1 of Article 3 of LCIT LR

## • Object of corporate income tax (base)

The tax base of a Lithuanian entity is all income earned in the Republic of Lithuania and foreign countries, which is sourced inside and outside the Republic of Lithuania.

The tax base does not include the income from activities carried out through the permanent establishments of the Lithuanian entity located in the countries of the European Economic Area (EEA) or in the states with which Lithuania has concluded and applies treaties for the avoidance of double taxation (hereinafter referred to as the TADT), if the income from activities carried out through these permanent establishments is taxable by the same corporate income tax (or tax equivalent) in those countries by established procedures. The tax base of a foreign entity is:

- Income from activities carried out by a foreign entity through permanent establishments situated in the territory of the Republic of Lithuania, income from international telecommunications earned through permanent establishments situated in the Republic of Lithuania and 50 per cent of income from transportation which commences on the territory of the Republic of Lithuania and ends abroad or starts abroad and ends in the territory of the Republic of Lithuania, income earned in foreign countries assigned to those permanent establishments in the Republic of Lithuania in the event that such income relates to the activities of a foreign entity through permanent establishments in the Republic of Lithuania
- Income sourced in Lithuania and received otherwise than through a permanent establishment situated in the territory of the Republic of Lithuania <sup>6</sup>

## • The procedure for determining the basis of corporate income tax

The income tax is calculated not from the total income received by the taxable entity, which forms the subject of this tax, but only from taxable profit, i.e. from the part of the income earned (received) by the taxable entity, which remains after deduction of operating expenses and allowable deductions.

<sup>6</sup> Paragraph 3 of Article 4 of LCIT LR<sup>2</sup> Paragraph 1 of Article 1 of LR

When calculating the taxable profit of Lithuanian entity, the following is deducted from its income: non-taxable income, allowable deductions, deductions of limited amounts<sup>7</sup>.

The taxable profit of permanent establishments of foreign entities is calculated by deducting the same non-taxable income from the earned income and the same allowable deductions of the limited amounts as for Lithuanian entities, as well as such deductions that are related to earning of income by foreign entity through permanent establishments.

The taxable profits earned by a foreign entity otherwise than through a permanent establishment shall include all of its income sourced in the Republic of Lithuania and the obligation to tax it at source (without any deductions)<sup>8</sup>.

## • Corporate tax rates<sup>9</sup>

### Main 15% tax rate is imposed:

- On the taxable profits of Lithuanian entities and permanent establishments
- On income from distributed profits
- On sponsorship received which is used for purposes other than specified and that part of sponsorship received in cash from a single provider of sponsorship during the tax period, which exceeds the amount of EUR 9,500 (without any deductions)
- On foreign entities - income for the sale, transfer or otherwise transferred to the ownership or leased immovable thing by nature situated in the territory of the Republic of Lithuania, income from performing and sports activities carried out in the Republic of Lithuania

### 10% tax rate is imposed:

- On foreign entities - royalties, income from compensation for violation of copyright or related rights
- On foreign entities not registered or otherwise organized in the EEA state or in the state with which the TADT treaty is concluded and applied, interest other than interest on Government securities, interest accrued and payable on deposits and interest on subordinated loans

### 5% tax rate is imposed:

- On taxable profits of entities (except for non-profit entities) whose average number of employees on the list does not exceed 10 and whose income over the tax period does not exceed EUR 300 000

<sup>7</sup> Paragraph 1 of Article 11 of LCIT LR

<sup>8</sup> Paragraph 3 of Article 11 of LCIT LR

<sup>9</sup> Article 5 of LCIT LR

**This rule does not apply to:**

- Entities (individual/personal entities) whose members and/or family members of such members control, on the last day of the tax period, over 50% of the shares (interests, member shares) in other entities as well as entities in which members of other entities (individual/personal enterprise) and/or family members of such members control, on the last day of the tax period, over 50% of the shares (interests, member shares)
- Entities in which the same member controls, on the last day of the tax period, over 50% of the shares (interests, member shares)
- Entities in which the same members jointly control, on the last day of the tax period, over 50% of the shares (interests, member shares)
- Entities, whose income during the tax period comprises more than 50% of income from agricultural activities, including income from cooperative companies (cooperatives) for the sale/purchase of agricultural products produced by their members

**Mixed taxable income is imposed:**

- That part of taxable profits of non-profit entities, whose income from economic and commercial activity over the tax period does not exceed EUR 300 000, which amounts to EUR 7,250 shall be taxed at a rate of 0% and the remaining part of taxable profits shall be taxed at a rate of 15%.

Income not attributable to the economic activity of non-profit entities, which is directly attributed to the financing of activities carried out in the public interest.

**Income tax is not imposed:**

- On profit of social enterprises and cooperative companies (cooperatives) if they meet certain requirements established by laws;
- In interest of foreign entities that are registered or otherwise organized in the EEA state or in the state with which the TADT treaty has been concluded and applied.

Also, corporate income tax shall not be paid by budget-financed institutions, the Bank of Lithuania, the State and municipalities, state and municipal institutions, agencies, services or organisations, state company “Deposit and Investment Insurance”, European Economic Interest Groupings<sup>10</sup>.

<sup>10</sup> Paragraph 2 of Article 3 of LCIT LR

## • Tax period

The corporate income tax period is the fiscal year that coincide with a calendar year.

At the request of the taxpayer and taking into account the characteristics of its activity, the local tax administrator may set other tax period subject to condition that the tax period is 12 months <sup>11</sup>.

## • Corporate income tax reliefs <sup>12</sup>

The following entities have the right to a lower corporate income tax rate:

- Enterprises of free economic zone (hereinafter referred to as FEZ). FEZ enterprise (except for credit institution or insurance company) in which capital investments amount to at least EUR 1 million shall not pay corporate income tax for 6 tax periods beginning with the tax period in which such an amount was reached and shall be subject to a 50% reduced corporate income tax rate for the subsequent 10 tax periods
- An enterprise of free economic zone whose average number of employees in a tax year is not less than 20 and in which capital investments amount to at least EUR 1 million shall not pay corporate income tax for 6 tax periods beginning with the tax period in which such an amount was reached and shall be subject to a 50% reduced corporate income tax rate for the subsequent 10 tax periods

The relief may be applied only where not less than 75% of the income of a free economic zone enterprise for the relevant tax period comprises income from certain types of activities specified by the law.

The relief may be applied only in the event that the free economic zone enterprise has an auditor's report confirming the required amount of capital investments.

- Legal persons whose income from own production exceeds 50% of the total income received and which employ persons with limited capacity for work shall reduce the calculated corporate income tax as follows

<sup>11</sup> Article 6 of LCIT LR

<sup>12</sup> Paragraph 16 of Article 58 of LCIT LR

## • Income tax of individuals

Proportion of persons with a limited work capacity within the total of persons employed	Reduction of calculated corporate income tax
More than 50 %	100 %
40–50 %	75 %
30–40 %	50 %
20–30 %	25 %

Income tax shall be paid by any individual who has derived and/or earned income. The Law on Income Tax of Individuals of the Republic of Lithuania (hereinafter referred to as LITI LR) establishes the procedure for imposing income tax on the income of individuals.

## • Payers of income tax of individuals

All income derived and/or earned by residents who pay the income tax of individuals are divided into permanent and non-permanent residents of Lithuania.

A permanent resident of Lithuania is any natural person whose permanent place of residence is in Lithuania, or whose place of personal, social or economic interests is in Lithuania rather than in a foreign country, or any natural person who stays in Lithuania most of time. The concept of a permanent resident of Lithuania is clearly specified in paragraph 1 of Article 4 of the Law on Income Tax of Individuals of the Republic of Lithuania. All other natural persons are considered non-permanent residents of Lithuania.

## • Object of income tax of individuals

The object of income tax of individuals is the income of a resident – the remuneration received during the tax period for the performed works, services rendered, transferred or granted rights, the income from the individual activities, the income for the sale or otherwise transferred, invested property (funds), or other benefit received by the resident in cash or kind <sup>13</sup>.

Non-permanent residents of Lithuania pay the income tax of individuals from income the source of which is in Lithuania.

<sup>13</sup> Paragraph 1 of Article 5 of LITI LR

Two types of activity of a resident of a different nature are distinguished – work activities carried out based on the employment-based relations or the relations corresponding to their essence, and individual activities.

Although paragraph 1 of Article 5 of LITI LR stipulates that the tax object is the income received by a resident, but the income tax of individuals is calculated and paid not from the total income of the individuals, but only from the taxable income which forms the basis of this tax after deduction of corresponding tax-exempt types of income and/or allowable deductions.

## • Rates of Income Tax

Total income tax rate is **15 %**.

The **5% income tax rate is imposed on income from individual activity**, with the exception of income from liberal professions activity, as well as on income from non-individual activities received after selling base metal scrap or otherwise transferring it into ownership.

A resident may choose to pay a fixed rate income tax on income from individual activities if he is not required to register and is not registered as a value added taxpayer.

## • Value Added Tax (VAT)

**The object of VAT** is the supply of goods and services effected for consideration within the territory of the country when the goods and services are supplied by the taxable person in the course of his economic activity. The VAT object is also an acquisition of goods for consideration within the territory of the country from another Member State. The object of import VAT is the import of goods when the goods are deemed to have been imported into the territory of the country.



## • Regulation in Lithuania

VAT has been introduced in Lithuania since 1 May 1994 after the entry into force of the Law on Value Added Tax of the Republic of Lithuania. This law was valid until 30 June 2002. Since 1 July 2002, the new version of the Law on Value Added Tax of the Republic of Lithuania came into force, which implemented all basic legal acts of the European Union regulating VAT taxation, but the requirements were not transposed into the law, the application of which is possible only in the case of Lithuania as a member of the European Union and a part of the common market. On 15 January 2004, the Law amending and supplementing the Law on Value Added Tax No IX-1960 of the Republic of Lithuania, which came into force from 1 May 2004, was adopted. This law has definitively transposed the provisions of European Union legislation regulating the procedure for VAT taxation.

## • VAT rates

**Standard VAT rate is 21 %**

**The reduced rate of VAT of 9% is applied to**

- Most of the literature, information publications, textbooks, newspapers, magazines and other publications of a similar nature
- Passenger transport services by regular routes as well as transportation of passenger luggage services
- Accommodation at hotels and other special accommodation services

**The reduced rate of VAT of 5% is applied to**

- Technical support means for the disabled and repairs thereof
- Pharmaceuticals and medical aid measures, where the costs of acquiring these goods are reimbursed fully or partially, as well as non-compensated prescription medicines the taxable value of which exceeds EUR 300

## • VAT payers

VAT payer is a person who has a duty to calculate and pay VAT and who is registered by the tax administrator as a VAT payer, including persons registered for VAT purposes other than that.

Taxable persons who supply goods or services in the territory of the country must register as VAT payers and to calculate VAT and pay it to the budget. Taxable persons of the Republic of Lithuania may not register as VAT payers and do not calculate the VAT for goods supplied (with the exception of new vehicles supplied to other Member States) and/or services provided and not to pay it into the budget if the total remuneration amount for goods and/or services provided in the course of an economic activity during the year did not exceed EUR 45 000.

It is not obligatory to register as a VAT payer if the value of the products (except for new vehicles or excisable goods) purchased by the taxable person of the Republic of Lithuania from other Member States exceeded EUR 14 000 in the previous calendar year and this threshold is not foreseen in the current calendar year.

There is also a possibility for voluntary registration as VAT payers in cases where the mentioned registration limits are not exceeded.

## • Tax Period

A tax period is a calendar month, but in some cases, a calendar half-year or another period can also be set. If the tax period is a calendar month, the VAT tax return for the tax period must be submitted and the amount of VAT payable is paid no later than by 25th day of the next month.

The Law on Value Added Tax of the Republic of Lithuania also specifies cases, where the supply of goods, provision of services and the purchase of goods from another Member State is not subject to VAT, as well as the cases, where imported goods are exempt from import VAT, special schemes for VAT taxation (compensatory VAT rate for farmers, tourism services, second-hand goods, works of art, collectible and antique items, investment gold and special telecommunications, radio and television broadcasting and/or services provided electronically), etc.

## • State social insurance contributions

Social insurance contributions are paid into the budget of the Fund and are intended to finance the types of social insurance benefits. The types of social insurance are as follows:

- Social insurance of pensions
- Social insurance of illness
- Social insurance of maternity social
- Insurance of unemployment
- Social insurance for accidents at work and occupational diseases.

Payers of social insurance contributions are insurers, policyholders, self-employed persons and persons who are insured with state voluntary social insurance.

Insurers are legal entities, other organizations or their subdivisions (branches, representative offices), as well as natural persons who must pay state social insurance contributions. The legal entities of the Republic of Lithuania, individuals engaged in individual activities, self-employed persons, etc. are recognized as insurers.

Policyholders are natural persons who pay state social insurance contributions themselves and/or the insurers pay contributions for them. Persons insured with social insurance are persons working under employment contracts, civil servants, officials, etc.

The social insurance contributions of the persons employed under employment contracts, civil servants and categories of similar types of insured persons are calculated from the amount of wage computed for each insured person.

Unlike other taxes and compulsory contributions, there are no permanently valid sizes of social insurance contributions (rates).

## • **Compulsory health insurance contributions**

Citizens of the Republic of Lithuania and foreigners, who permanently reside in Lithuania, as well as foreigners legally working and temporarily resident in Lithuania, must pay compulsory health insurance contributions. The payers of compulsory health insurance contributions are insured persons and/or insurers – legal entities and their branches and representation agencies.

The basic amount of the compulsory health insurance contribution is 3%. The insured persons pay 3% of compulsory health insurance contributions from the income calculated from the income computed in accordance with the procedure established by the Law on State Social Insurance from which social insurance contributions are calculated for persons.

This system of personal healthcare and economic measures guarantees the provision of healthcare services to the insured persons and the reimbursement of expenses for the provided services.

## • Contributions to the Guarantee Fund

The State Social Insurance Fund Board under the Ministry of Social Security and Labour and other administration institutions of State Social Insurance Fund took over the execution of the administration function of the Guarantee Fund from 1 January 2017. Until then, the State Tax Inspectorate was responsible for the administration and regulation of these contributions.

The purpose of the Guarantee Fund (contributions to it) is to pay flat-rate payments to employees of bankrupt and failed enterprises who worked in an enterprise prior to the court ruling to initiate bankruptcy proceedings against the enterprise or to carry out the bankruptcy proceedings by extrajudicial procedures before the meeting of creditors, irrespective of whether the labour relationships continue or are terminated, as well as former employees of enterprises when companies are indebted to them.

Contributions to the Guarantee Fund are paid by all legal entities (enterprises, public institutions, banks, credit unions), except for many state institutions. Contributions must also be paid by units of legal entities of the Member States of the European Union established in the Republic of Lithuania.

These companies pay 0.2% of the amount of wage calculated to employees (from which the state social insurance contributions are calculated).

## • Other taxes

### REAL ESTATE TAX

- The object of the tax is real estate paid by real estate owners - natural and legal persons
- The tax rate is from 0.3% to 3% of the tax value of the real estate
- The tax value of real estate is the average market value of real estate based on which the tax rate is determined.

### LAND TAX

Land tax is similar to the abovementioned real estate tax. The object of the tax is private land owned by the natural and legal persons in the Republic of Lithuania, with the exception of forestland and agricultural land. Like the real estate tax, the land tax is paid by natural and legal persons. The tax base is the taxable value of the land, which is equal to the average market value of the land. The tax rate may range from 0.01% to 4% of the taxable value of the land.

# Lithuania | FOREIGN INVESTMENT

- **State profile**

The Republic of Lithuania is a member of the European Union and belongs to the Schengen area; therefore, the free movement of goods and persons is ensured for investors from the European Union. Lithuania belongs to the euro area and uses the common currency of the European Union - the euro. One of priorities of Lithuania foreseen in the progress strategy of the state is the attraction of investments from all over the world; therefore, the policy pursued by Lithuania is aimed at promoting the growth of foreign investment. Good conditions have been created in Lithuania for the training of young professionals who are great request in international companies. Almost every young professional in Lithuania fluently speaks English, many of them speak Russian, and the number of those speaking Scandinavian languages is growing steadily. Each year, engineering, production and construction studies are chosen by twice as large as the average in the European Union, while IT professionals are trained and employed mostly in the European Union.

Lithuania also has good infrastructure and favourable conditions for investing in the Republic of Lithuania. Lithuania can offer the fastest communications for investors: one of the fastest internet speeds in the world (penetration of broadband Internet in Lithuania is the largest in the EU) and well-developed logistics that allows fast access to both Eastern and Western Europe. The Lithuanian business sector meets all EU standards. To foreign investors, whose business needs production and transportation, Lithuania can offer 750 million potential customers, who can be reached within 1-5 days. Lithuania has signed the treaties with the 50 largest markets in the world that help avoiding double taxation, including China, Russia and the United States.

There are currently seven special economic zones in Lithuania, where preferential terms apply to business (for example, in the free economic zones, the investor does not pay income tax for the first 6 years, while other 10-year profit is taxed only 7.5% (elsewhere in Lithuania 15%), while dividends received by foreign investors in a free economic zone are not taxed (elsewhere in Lithuania 15%). There are also five integrated science, studies and business centres (valleys) in Lithuania, in which exceptionally good conditions are created for investors to invest in research and experimental development. Those who invest in high technology and innovation are provided with various tax reliefs (such as the permit to deduct the costs of enterprises incurred during the research and development projects from income three times).

## • Investment in Lithuania

In accordance with national and European Union legislation, as well as bilateral agreements concluded by Lithuania on investment promotion and mutual protection, Lithuanian and foreign investors must be guaranteed equal conditions for activities, while the rights and legitimate interests of investors are protected by the laws of the Republic of Lithuania.

Foreign investment in the Republic of Lithuania and investments of the investors of the Republic of Lithuania abroad are also regulated by bilateral and multilateral agreements between the Republic of Lithuania on the promotion and protection of investments and other international treaties. If the international treaty ratified by the Seimas of the Republic of Lithuania establishes different conditions for foreign investments in the Republic of Lithuania than the laws, the rules of the international treaty shall apply.

The Law on Investment of the Republic of Lithuania provides for that investors can invest in Lithuania by employing the following methods <sup>1</sup>:

- By setting up an economic entity, acquiring the capital of an economic entity registered in the Republic of Lithuania or a share therein as well as by lending funds or other assets to economic entities, in which the investor owns a share in the capital, enabling them to control the economic entity or to exert a considerable influence thereon
- By acquiring securities of all types
- By creating, acquiring fixed assets or increasing the value thereof;
- By executing concession contracts and contracts of lease with option to purchase

## • Investment in economic entities

Investment in the Republic of Lithuania is permitted in all lawful commercial-economic activities, subject to the restrictions established by this Law and other legal acts of the Republic of Lithuania <sup>2</sup>.

<sup>1</sup> Article 4 of the Law on Investment of the Republic of Lithuania

<sup>2</sup> Article 8 of the Law on Investment of the Republic of Lithuania

## • Restrictions

The Law on Investment of the Republic of Lithuania provides for that investment shall be permitted in all lawful commercial-economic activities; however, the fact that the law provides for the following restrictions to the foreign investors should be taken into account:

- Foreign investments are not allowed in state security and defence (except for the investment by the foreign entities meeting the criteria of European and Transatlantic integration which Lithuania has opted for, provided this is approved of by the State Defence Council).
- Investments in the economic sector of strategic importance to national security or facilities of particular strategic or strategic importance to national security within the territory of the protection zone of importance to national security shall be allowed only after the assessment of the compliance of potential participant with the national security interests of the Republic of Lithuania in the cases and in the manner prescribed by the law on the relevant enterprises and facilities of strategic importance to national security and other enterprises of importance to national security ensure.

It is also worth mentioning that when investing in an established economic entity, whose activities under the laws governing that area of activity are licensed, the entity must acquire a licence in accordance with the procedure established by laws and other legal acts.

## • Investment in an entity of the EU and EEA countries

Lithuanian investors and foreign investors from the EU and EEA countries are subject to the same conditions. Foreign investors usually choose to set up private limited liability companies or branches of a foreign company in Lithuania. The procedure and conditions for the establishment of these and other economic entities are specified in detail by the Law on Companies of Republic of Lithuania.

When acquiring a the capital of the company or a part thereof, particular attention should be paid to the established procedure for notifying of such actions and whether the management body of the company has taken a decision on the transfer of capital in accordance with the provisions of the law and the articles of association of that company. Failure to comply with these requirements may result in invalidation of the investment in question and, of course, the losses of the investor.

Attention should be drawn to the fact that investing by lending funds or other assets to economic entities in which the investor owns a part of the capital, enabling him to control or exercise significant influence on the entity is permitted as lent exclusively to the person related to the investor, and therefore this type of investment does not include credit activities. Foreign entities wishing to engage in credit activities must comply with the Law on Banks of the Republic of Lithuania and the Law on Credit Unions of the Republic of Lithuania, which provide for the procedure for the establishment, licensing, operation, termination and reorganization and supervision of credit activities.

## • Arriving to establish/manage a business and live in the Republic of Lithuania

### ► As an owner, participant or manager of the company

#### Requirements for a person

- You must be a participant of the company (a manager or a shareholder of UAB or AB holding at least 1/3 of the authorized capital of the company)
- You must have investments in cash or kind worth at least EUR 14,000 (not applicable to company managers)

#### Requirements for the company

- A business plan for the activities of at least 6 months;
- The citizens of Lithuania, other EU or EFTA Member States or foreigners permanently residing in the Republic of Lithuania working full-time, whose the monthly wage paid in total represent at least 2 figures of the average gross monthly salary of the last published national employees of the Statistics Department of Lithuania (EUR 1,677)
- Equity value amounts to at least EUR 28,000

#### Condition

- Family members can be brought in (at the same time family members can apply for a temporary residence permit in Lithuania)

### ► As a starter

#### Requirements

- A person intending to engage in legal activities related to the introduction of new technologies or other significant innovations in the field of economic and social development of the Republic of Lithuania (a document proving this is required, namely the letter of Public Enterprise "Versli Lietuva", confirming that the legal activity which the foreigner intends to engage with is related to new technologies, etc).

#### Condition

- A starter is issued a permit for temporary residence for one year and may be replaced for one year only once.



## • Arriving to work and live in the Republic of Lithuania <sup>3</sup>

### ► As an employee

#### Requirements

- A work permit in a company registered in the Republic of Lithuania (issued to an employer through a territorial labour exchange);
- After obtaining the work permit, you can apply to issue a national visa or a permit for temporary residence in Lithuania;
- Have sufficient amount of funds for living (the amount of funds for living is minimum one monthly salary per month).

#### Conditions

- A permit for temporary residence in Lithuania is issued for one year, therefore, in order to stay and work in Lithuania, it is necessary to apply to the Migration Service for the renewal of this permit
- Family members can be brought in only after two years of legal life and work in Lithuania
- During the permit for temporary residence, you can work only with the employer who has undertaken to employ you, applying for the issuance of work permit for you or the decision regarding the compliance of your work with the needs of the Lithuanian labour market

### ► As the employee of high qualification

#### Requirements

- A higher education diploma or at least 5 years of professional experience equivalent to the qualification of higher education
- The wage in Lithuania will be not less than 1.5 of the average gross monthly salary of the last published national economy of Statistics Department of Lithuania

#### Conditions

- Family members can be brought in (at the same time family members can apply for a permit for temporary residence in Lithuania)
- You can change the employer with the permission of the Migration Department (for the first two years)

### ► As an outsourced employee of a foreign company

#### Requirements

- A permanent employee of the company specified in the founding documents carrying out the activities for a period of at least 6 months,;
- An employee is sent to work in a company in the Republic of Lithuania according to a contract concluded between these companies for the provision of services or performance of works as a specialist in accordance with the existing professional qualification;
- To be insured with social insurance in the country of origin for the last three months and to remain insured throughout the period of the mission in Lithuania.

#### Conditions

- May be placed on detached services for a maximum of one year
- Family members cannot be brought in

<sup>3</sup> Article 44 of the Law on the Legal Status of Aliens of the Republic of Lithuania

In all cases, you must pay state fees when applying for a residence permit in Lithuania (except for the cases where a person is exempted from the levy).

## • Investment by acquisition of all types of securities

### Securities in free circulation on the market

- Shares and bonds of public limited liability companies being sold through the Stock Exchange in accordance with the procedure of the legislation on the financial markets of the Republic of Lithuania, securities of the Republic of Lithuania and other legal acts

## • Securities Stock Exchange in Lithuania

AB “Nasdaq Vilnius” is a securities stock exchange operating in Lithuania. This is a market participant licensed by the Bank of Lithuania, the only operator of the regulated securities market and alternative securities market “First North” in Lithuania. AB “Nasdaq Vilnius” provides services related to trading in securities, listing securities and information services.

## • Market supervision

The securities market is regulated and supervised by the Bank of Lithuania in accordance with the Law on Markets in Financial Instruments of the Republic of Lithuania.

The Bank of Lithuania, exercising market control, issues licences and permits to the participants of the Market in Financial Instruments, restrains and cancels their validity, monitors and controls that the market participants would operate stably, are reliably managed and able to fulfil their obligations. In addition, the Bank of Lithuania supervises the compliance of regulated market participants with fair trade rules, and the investors would receive the mandatory information that must be disclosed as prescribed by the legislation. The purpose of the control is to ensure that when providing investment services, the investors are treated honestly, fairly and professionally so that they would receive all necessary information to allow them to make rational investment decisions.

In order to create the most favourable conditions for the development of the capital market, the Bank of Lithuania ensures the quality of regulation and legal certainty: submits proposals on the national economic policy, promoting the development of financial instrument markets, disseminates the information about the principles of the functioning of financial instrument markets and takes other measures to implement the Law on Markets in Financial Instruments and other legislation related to the financial instruments market.

## • Regulated market and over-the-counter trade

The regulated secondary turnover in securities in Lithuania is organized by the securities stock exchange “Nasdaq Vilnius”. “Nasdaq Vilnius” is a self-regulating organization that adopts and enforces the rules and regulations governing the listing, trading and other procedures on the “Nasdaq Vilnius” stock exchange. Transactions executed outside the stock exchange are executed through the intermediaries of public turnover in securities, who must report the concluded transactions to the stock exchange “Nasdaq Vilnius”.<sup>4</sup>

## • Protection of foreign investors

Investors have the right to convert the profit (income) owned by them by property right, after paying taxes in accordance with the procedures prescribed by the laws of the Republic of Lithuania (dividends received by foreign investors are taxed at the corporate income tax rate of 15%) into foreign currency and/or transfer it abroad without restrictions. Trading in securities of restricted turnover:

- Stocks and shares of private limited liability companies sold under the procedure established by the Civil Code of the Republic of Lithuania and the law regulating separate types of companies (Law on Companies of Republic of Lithuania; Law on Small Societies of the Republic of Lithuania).

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<sup>4</sup> Nasdaq Baltic website <http://www.nasdaqbaltic.com/market/>

It is necessary to note that when trading in securities with limited turnover, it is necessary to observe the procedure provided for by laws, otherwise the purchase of securities may be recognized as unlawful. When purchasing shares of a private limited liability company, it is necessary to take into account the proper implementation of the peculiarities of the transfer of shares provided for in the Law on Companies of the Republic of Lithuania and the Civil Code of the Republic of Lithuania:

#### **PRE-EMPTIVE RIGHT OF OTHER SHAREHOLDERS <sup>5</sup>**

First, a shareholder must give a written notice to a private limited liability company of his intention to sell all or a part of the shares in a private limited liability company and indicate the number of shares being disposed of according to their classes and selling price. 2. The right of pre-emption to acquire all shares offered for sale in a private limited liability company shall be vested in the shareholders who, on the day of receipt of the shareholder's notice of his intention to sell shares in a private limited liability company.

If, within the time limits laid down in laws (30 days), the manager of a private limited liability company informs the shareholder that other shareholders do not wish to acquire all the shares offered for sale or fails to submit the notice, the shareholder shall be entitled to sell the shares at his own discretion at the price not lower than that indicated in his notice of the intention to sell the shares.

The law provides for that a different procedure for the sale of shares may be established in the articles of association of the private limited company; therefore, it is necessary to ascertain whether the pre-emption right of other shareholders to the securities being sold has been properly implemented (in accordance with the Law on Companies of the Republic of Lithuania and the articles of association of the company).

#### **COMPETITION COUNCIL <sup>6</sup>**

Secondly, investing in this way, the compliance with the requirements of the Law on Competition and, in certain cases (acquisition of shares of the company dominant on the market or the shares that will allow an investor to gain a dominant position on the market) – to obtain a permit from the Competition Council – must be observed.

<sup>5</sup> Law on Companies of the Republic of Lithuania

<sup>6</sup> Law on Competitions of the Republic of Lithuania

**CONTRACT FORM <sup>7</sup>**

Thirdly, it should be noted that the Civil Code of the Republic of Lithuania provides for a notarial certification of the contract on sale and purchase of shares of private limited liability companies when selling 25 per cent or more of the shares of a private limited liability company, or the sale price of shares exceeds EUR14,500 (except when the personal securities accounts of shareholders are managed in accordance with the procedure established by legal acts regulating the securities market).

- **Investment by acquiring or creating short-term assets**

The foreigners wishing to invest in this way and acquire the land, should pay particular attention to the constitutional law implementing Paragraph 3 of Article 47 of the Constitution of the Republic of Lithuania. This law provides for the conditions, procedures and restrictions observing which the foreign entities can acquire land, inland waters and forests by right of ownership. Under this law, to acquire the land, inland waters and forests by right of ownership are allowed only the foreign entities that meet the criteria for European and transatlantic integration chosen by Lithuania. The criteria for the European and transatlantic integration chosen by Lithuania are met by foreign legal entities, as well as other foreign organizations, established:

- In the Member States of the European Union or in the states, which have entered into the European Agreement (Association Agreement) with the European Communities and their member countries
- In the states-members of the Organization for Economic Co-operation and Development, the North Atlantic Treaty Organization and the states party to the Agreement on the European Economic Area

The criteria for the European and transatlantic integration chosen by Lithuania shall be the citizens of the states specified in paragraph 1 of this article and the permanent residents of these foreign states as well as permanent residents of the Republic of Lithuania, who do not have citizenship of the Republic of Lithuania.

This law provides for a ban on the sale of land, inland waters and forests until the property rights of citizens of the Republic of Lithuania are restored. Therefore, before purchasing, it is necessary to check the history of the object to be purchased (whether a citizen of the Republic of Lithuania has no right to restore ownership).

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<sup>7</sup> Civil Code of the Republic of Lithuania

The procedure for acquiring another immovable property located in Lithuania is carried out in accordance with the rules of the Civil Code of the Republic of Lithuania, which does not highlight any additional requirements for foreign entities. Attention should be drawn to the fact that this type of investment in the free economic zones is defined in the Law on Free Economic Zones of the Republic of Lithuania; therefore, the prohibitions of activities provided for in this law should be taken into account.

## • Investment by

### **CONCESSION CONTRACT**

The concession contract is concluded between the investor and the institution acting on behalf of the state or municipality. There is an agreement on the possibility to carry out specific, certain types of economic activities in Lithuania related to the design, construction, development, renewal, replacement, repair, management, use and maintenance of infrastructure facilities, the provision of public services, the management and use of state or municipality property (including exploitation of natural resources).

Lithuanian and foreign concessionaires are equal according to the laws and in the course of their activities in accordance with this and other laws of the Republic of Lithuania shall not be discriminated, with the exception of restrictions already discussed that are applied to them.

### **LEASING AGREEMENT**

Investment by means of leasing is regulated by the general procedure established by the Civil Code of the Republic of Lithuania<sup>8</sup>. This procedure applies to both Lithuanian and foreign investors, which provides for that any non-utilized movable and immovable property, with the exception of land and natural resources, may be the object of a leasing agreement.

<sup>8</sup> Articles 6.567 - 6.574 of the Civil Code of the Republic of Lithuania

## PARTNERSHIP AGREEMENT BETWEEN PUBLIC AND PRIVATE ENTITIES

The terms, procedure and features of the partnership agreement between public and private entities are provided for in the Law on Investments of the Republic of Lithuania. Under partnership agreement between public and private entities, a public entity provides a private entity with activities related to the design, construction, reconstruction, repair, renewal, management, use and maintenance of infrastructure, as well as related to the management or use of state-owned or municipal assets, new or transferred to it, and the provision of public services in the fields of transport, education, health and social protection, culture, tourism, public order and public protection, and in other areas provided for in the laws regulating the activity and functions of the public authority.

During the implementation of the partnership agreement between a public and private entity, the public authority grants the right to manage and use the state-owned or municipal assets necessary for the pursuit of such activities and undertakes to pay the private entity the remuneration for the activities it carries out, and the private entity undertakes to perform the activities specified in the contract and to ensure the investments necessary for carrying out this activity and to develop the necessary assets or transferred for management and use to improve the state of the assets.

### • Protection of rights of investors (guarantees)

The protection of investors in Lithuania is ensured by the standards provided for in national and international legal acts on the protection of rights of investors:

- Prohibition of expropriation of investments without paying right compensation
- The obligation to treat investments fairly and honestly and do not violate the legitimate expectations of investors
- Full investment protection, ensuring the physical protection of investment and exercising the right to use the national judicial system effectively

### • Protection of Investment in the Event of Expropriation

The Law on Investments of the Republic of Lithuania stipulates that Expropriation of the object of investment shall be allowed only in the cases specified and according to the procedure set forth in the laws of the Republic of Lithuania and only for public needs, paying the investor/investors just compensation in the manner prescribed by the Government (not later than within 3 months). The amount of compensation for the object of investment taken shall be determined in accordance

with the procedure established by the Law of the Republic of Lithuania on the Principles of Property and Business Assessment and other legal acts and must correspond to the market value of the said object prior to the expropriation or prior to public declaration thereof, whichever happens earlier.

Upon the request of a foreign investor, compensation shall be paid in any currency for which London Inter Bank Offered Rate (LIBOR) is quoted. The sum of compensation shall be converted according to the official exchange rate of the euro against the foreign currency announced by the Bank of Lithuania on the day of assessment.

## • Damage to investors

In accordance with international and national legislation, state and municipal institutions and officials have no right to hinder investors from managing and using an investment object and disposing of it in accordance with the procedure established by laws. Damage caused to an investor by illegal actions of state or municipal institutions and their officials shall be compensated in accordance with the procedure established by the laws of the Republic of Lithuania.

## • Dispute resolutions

Disputes concerning violation of investors' rights and legitimate interests are resolved in accordance with the procedure established by the laws of the Republic of Lithuania. Disputes between foreign investors and the Republic of Lithuania regarding violation of their rights and legitimate interests (investment disputes) are examined by courts of the Republic of Lithuania, international arbitrations or other institutions by agreement of the parties.

Investment disputes are also resolved in accordance with the provisions of international treaties. In the event of investment disputes, foreign investors have the right to apply directly to the International Centre for the Settlement of Investment Disputes.<sup>9</sup>

<sup>9</sup> The Law on Investments of the Republic of Lithuania



## • Labour law system in Lithuania

The main legal act regulating labour relations in Lithuania is the Labour Code. It regulates social relations related to individual labour relations (relations prior to the conclusion of an employment contract and its termination, collective labour relations, consideration of disputes arising between participants of labour relations, relations related to observance and supervision of the law, etc.). Lithuanian labour law and labour relations are also regulated by the Constitution of the Republic of Lithuania, laws of the Republic of Lithuania governing labour relations in a narrower legal field (for example, guarantees to employees after their employer becomes insolvent and law on long-term employee benefits, law on trade unions, law on equal opportunities, law on remuneration of state politicians and state officials, etc.), European Union legislation, international agreements concluded by Lithuania, Government resolutions (for example, Government resolutions on minimum wages, etc.) as well as normative legal acts of other state institutions (decrees of the ministries, municipalities, etc.) and collective agreements concluded by the participants of the employment relationships themselves, various agreements between the employer and labour councils and local legal acts.

The labour law system in Lithuania consists of the general part of labour law, individual and collective labour relations. The general part of labour law includes the rules of law regulating labour relations, which establish the general principles of labour law relations, the subject of labour law, sources, subjects of labour relations and other essential peculiarities of legal regulation of labour relations in the Lithuanian labour law system. Individual labour relationships include the labour relationship between the employer and the employee, the basis for the emergence, termination of their labour relationships, establishes various social guarantees and their implementation during the labour relationship, the means of legal settlement of disputes arising between the employer and the employee, etc. Meanwhile, collective labour relations are implemented based on the social partnership principle. The representatives of employees and representatives of employers and their organizations are considered the parties of social partnership or social partners. By the collective partnership, through their representatives, the employees exercise their rights, can negotiate with employers on better working conditions and deal with other collectively solvable issues.

In order to make legal regulation of labour relations the most efficient, rational for both employees and employers and to distribute the rights of the parties of labour relations, obligations and various responsibilities of employers and employees more evenly, one of the most important changes took place in the Lithuanian labour

law system in 2017 - from 1 July 2017 the new Labour Code of the Republic of Lithuania came into force. The article deals with the relevant legal regulation of labour relations in Lithuania, which, before its entry into force, raised quite a number of discussions, received approval from certain social groups, as well as opposition of some of them. The new Labour Code, in comparison with the provisions of the previously effective Labour Code, provides for the reduction of sizes of various benefits and compensations, as well as minimizes various warning terms, encourages the parties to cooperate more closely and negotiate in the context of labour relations. It is likely that such changes in legal acts regulating the labour relations in Lithuania will encourage foreign employers to become more interested in the Lithuanian labour market and take effective advantage of labour law relations by investing in business and labour force in Lithuania.

## • Types of labour relationships

According to the system of labour relations prevailing in the country in general, in Lithuania labour relations are divided into individual labour relations and collective labour relations.

## • Individual labour relationships

Parties of individual labour relations are an employee and employer. Individual labour relations occur after the employer and employee have signed a written employment contract.

In this case, only a natural person, who, based on the employment contract, undertakes to perform the work function for the employer, is considered an employee. Under Lithuanian law only natural persons having legal capacity (the capacity to have employment rights and obligations) and ability (acquire full legal capacity in employment relationships by own actions and undertake employment obligations), which they acquire when they reach the age of 16 years, can be an employee.

An employer may be both a natural person and a legal entity in whose favour a natural person undertakes to carry out a work function for a remuneration. An employer may have one or more workplaces, in other words, structural organizational branches, representations or other structural, industrial, commercial or other activities that perform the employer's activities, in which the employer's employees can perform their work functions.

According to the law of Lithuania, a legal entity (1) under the jurisdiction of Lithuania, having legal capacity and ability to work (which he obtains from the moment of establishment of the legal entity, and a natural person obtains the legal capacity and ability to work as an employer from the age of 18), as well as (2) the subdivision of legal entity or other organization (branch, representative office) under the jurisdiction of a foreign state registered in the territory of the Republic of Lithuania, other organization, subdivision of a legal entity or other organization (branch, representative office) or a group of such persons can be an employer <sup>1</sup>.

## • Employment contracts

Individual legal employment relations arise from a legal fact called an employment contract. The contracts concluded between the employer and the employee define the necessary and additional conditions for the employment contract.

The essential terms of the employment contract are as follows: (1) job function, (2) payment conditions and (3) workplace. If these conditions are not agreed in the employment contract, the employment contract is not properly concluded and is invalid.

Additional terms of the employment contract are all different; the working conditions are determined by agreement between the employer and the employee (this may be a probationary period or determination of a term of employment contract, etc.). They specify the norms of labour law or establish an agreement between the employer and the employee regarding the fulfilment of work or other conditions related to the work, which is not contrary to labour law. Additional terms in the employment contract may not be discussed at all – in order for the employment contract to be properly concluded, it is important to agree on the necessary terms of the employment contract.

In Lithuania, previously it was only possible to conclude an employment contract of a fixed-term or indefinite duration, and after the entry into force of the new Labour Code from 1 July 2017, six more completely new types of employment contracts have appeared <sup>2</sup>.

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<sup>1</sup> Article 21 of the Labour Code of the Republic of Lithuania

<sup>2</sup> Paragraph 1 of Art. 66 of the Labour Code of the Republic of Lithuania

Employment contract	Peculiarity of employment contract	Term of employment contract
Non-term employment contract	Concluded between the employer and the employee for specific duties (e.g. manager, lawyer, accountant, etc.)	Unlimited term
Fixed-term employment contract	<p>Term may be set (f) by a certain date, until the performance of a particular task or until certain circumstances occur, change or terminate</p> <p>Fixed-term contracts of permanent nature may not exceed 20% of all concluded employment contracts</p>	<p>Up to two years - with one and the same employee, one or more successive contracts are concluded for performing the same functions</p> <p>Up to five years - several fixed-term employment contracts for different job functions are concluded with the same employee</p>
Temporary work employment contract	<p>A temporary employee undertakes to perform a job for a certain period of time for the benefit of the user of temporary work specified by the temporary employment agency</p> <p>The employer of a temporary work employment contract is not a user of temporary work, but a temporary employment agency, and therefore it pays the employee the wage</p>	<p>Fixed-term – up to three years;</p> <p>Unlimited term;</p>
Apprenticeship employment contract	<p>Concluded when the employee is recruited for the purpose of acquiring skills and qualifications necessary for a certain profession (often used by vocational school students)</p> <p>The employer can negotiate with the employee the reimbursement of training expenses incurred by the employer, which cannot exceed 20% of apprenticeship salary per month</p> <p>Apprenticeship contracts may not exceed 1/10 of the total number of employment contracts concluded by the employer</p>	<p>Up to six months</p> <p>For a longer period if the apprenticeship employment contract is concluded together with the training contract regulated by legal acts where longer training duration is defined</p>
Employment contract for project work	<p>Concluded for work functions required to achieve a specific result of the project</p> <p>The employee is paid the wage of not less than the minimum hourly rate, paying at least once a month</p> <p>The employee may determine working time regime by himself. Minimum working hours per week shall be discussed in the contract for project work</p>	<p>Up to two years – if the contract is concluded with a newly recruited employee</p> <p>up to five years - if the contract is concluded by replacing an existing type of employment contract with an existing employee by another type of contract</p> <p>up to two years - if the employment contract is concluded by leaving other type of employment contract in force due to the project work</p>

Job-sharing employment contract	<p>Under this contract two employees agree with an employer to share one job position without exceeding the maximum working time rate for one employee</p> <p>The working time regime may be changed by mutual agreement between the employees, after informing the employer. Agreements of employees on the allocation of working time cannot, in any way, affect the obligation of employees to work - in all cases, employees must replace each other at work in order to fulfil work</p> <p>If the employment contract with one of the employee is terminated, the employment contract of the other employee is valid for one month until the same contract is concluded with a new employee. If the partner is not found, the employer must offer the employee the employment in its entirety</p>	Unlimited or terminated based on the agreement with employees
Employment contract for several employers	<p>Under this contract, an employee can work for two or more employers by performing the same job function</p> <p>The contract must specify the first employer who will perform all functions of the employer in connection with the drawing up the work schedule, taxation of the employee's income, payment of social insurance and other contributions for this employee, submission of information about him to institutions, institutions, etc.</p> <p>The first employer represents all employers in labour disputes with the employee</p> <p>All employers are liable for obligations to the employee and for obligations related to the taxation of employee's income, the payment of social insurance and other contributions to public institutions</p>	Unlimited or terminated (based on the agreement with the employee and all employers)
Employment contract for seasonal work	<p>Contract is concluded for seasonal work. These are considered the works that, due to natural and climatic conditions, are not done for the whole year, just at certain periods (seasons), which are included in the list of seasonal works established by the Government of Lithuania</p>	Terminated, up to eight months within one year (12 months)

## • Remuneration

Remuneration is one of the necessary terms of the employment contract, and therefore must be discussed explicitly in the employment contract between the employee and the employer. Remuneration must be paid in cash (i.e., in the Lithuanian currency - euros) and its size may not be lower than established by the laws applicable to the employment relations, collective

agreements, other labour law norms or remuneration system approved in the workplace. The remuneration of each employee comprises <sup>3</sup>:

- Basic (rate-based) remuneration (hourly wage or salary)
- And premiums which are only intended to encourage the employee for well done work, activities or performance of his or company, subdivision or group of employees allocated on the initiative of the employer
- Premiums for the work done that can be fixed by agreement between the employer and the employee, or paid in accordance with the rules of labour law or the work remuneration system applicable at the workplace
- Additional part of the remuneration, which may be determined by agreement between the employer and the employee or compulsorily paid according to rules of labour law (for example, for doing works of certain level of hazard, in the case of a health hazard factors, or in the case of agreements on non-competition between the employer and employee, etc.) or according to the remuneration system applied at the workplace
- Premiums for additional work or additional duties or tasks
- As well as premiums for additional qualification,

If the size of remuneration established by laws is applied, then the contract must include a reference to the rules of labour law that determine it (for example, when agreeing to pay a minimum wage established in Lithuania, there must be a reference to the legislation which provides for the size of minimum wage applicable in Lithuania) <sup>4</sup>. Remuneration can also be determined by the system of remuneration at the workplace, employer's company or organization. Such a system of remuneration can be established by collective agreement, and in the absence of a collective agreement, at the workplaces (where the average number of employees is 20 or more employees), the payment systems must be approved by the employer and made accessible to all employees for familiarisation.

When applying the work classification system for determining the wage, or preparing general remuneration system for the employees at the workplace, the same criteria shall be equally applied to both men and women, and the remuneration system at the workplace must be developed in such a way so as to avoid discrimination on the grounds of sex. Men and women must be paid equal remuneration for the same or equivalent work. An equivalent work means that it is, according to objective criteria, of no lower qualification and equally important to the employer in pursuit of the goals than other comparable work. In other words, the same work means carrying out work activities that are identical or similar to other work activities to such an extent that both employer's employees can switch their works without the higher costs of the employer.

<sup>4</sup> Paragraph 3 of Art. 140 of the Labour Code of the Republic of Lithuania

## • Minimum wage

The minimum wage of the employee per month may not be lower than the established minimum wage. The minimum wage is determined by the Government of Lithuania.

The minimum wage in Lithuania (minimum hourly wage or minimum monthly wage) is the minimum allowable remuneration for unskilled work for an employee per hour or the full working time of a calendar month. Unskilled work is considered the work, where no any specific qualification or professional skills are required.

From 1 July 2016 July, in Lithuania the Government established a minimum hourly wage rate of EUR 2.32 and a minimum monthly wage of EUR 380. These provisions still apply in the 1st and 2nd half of 2017, however, since the employees are increasingly objecting against the minimum wage size, the Government and the Seimas started considering to increase the minimum wage by EUR 20. Meanwhile, while assessing the current economic situation in Lithuania, the economists of the country state that Lithuania is capable of raising the minimum wage by at least about EUR 40 (i.e. up to EUR 420 per month). The minimum hourly wage rate should increase proportionally. Such deliberations are not confirmed, but lately it is a matter of constant debate in Lithuania.

After the entry into force of the new Labour Code in Lithuania on 1 July 2017, the prohibition on the payment of minimum wage to qualified employees is foreseen. Qualified work is considered the work that requires certain specific qualification or professional skills, such as higher or vocational education in the relevant field, possession of special certificates, licences issued after appropriate training, etc.

If qualified employees work for the employer, the employer must formally pay at least minimally higher wage than the minimum monthly wage or minimum hourly wage rate established by the Government. What this size will be is the question of negotiations between the employee and the employer, the decision of which must be fixed in the employment contract.

A qualified employee can be paid a minimum wage only if he is fixed a shorter working time or he is employed to a workplace where an unskilled employee can work.

## • Working hours (average, maximum, overtime)

The rate of working time, the average and maximum working time is determined according to what is included in the specific working time. The working time may include:

- Basic working time of employee
- Overtime
- And additional working time, which is determined by a written agreement between the employee and the employer on additional work

The rate of basic working time in Lithuania is 40 hours per week, and the maximum working time of the main working time may not exceed 48 hours per 7 days (the main working time is the standard working time of an employee agreed by the employment contract, which does not include overtime or additional time).

However, for employees working on the basis of total working time accounting, the maximum working time, including overtime, but not including additional work in accordance with the agreement, may not exceed 48 hours calculated over the accounting period (the maximum accounting period is 3 months) on average during every 7-day period. If a total working time accounting in a particular workplace is established, the employees work during the time indicated in schedule (shifts). The employer must draw the work (shift) schedules in such a way as to distribute working time of the employees as evenly as possible throughout the accounting period; and it is prohibited to appoint the employee to work two shifts consecutively.

The maximum working time per one working day (one shift) may not be longer than 12 hours, excluding lunch break, and no more than 60 hours per 7 days. The period of 12 hours per day or 60 hours per 7 days must include (1) basic working time and (2) overtime as well as (3) additional work by individual agreements.

The fact is that any overtime work is possible only with the consent of the employee. During a period of 7 consecutive days, employees may not work longer than 8 hours of overtime (8 hours per week), and a verbal agreement between the parties is enough for this. Overtime can be increased up to 12 hours at maximum within the period of 7 days, but in such case, the employee must give his written consent. Duration of maximum overtime over full year may not exceed 180 hours. However, collective contracts between employees and employers can provide for longer overtime duration.



## • Missions and mission allowances

A mission is considered a performance of work duties by the employee in a place other than his permanent place of work. During the mission, the employee must be paid his wage, and in the event the employee incurs any additional costs that during the mission (for example, transport, travel, accommodation, etc.), the employer must compensate them.

For missions that take longer than one working day (shift) or when an employee is sent abroad, the employer must pay the employee a daily allowance - their maximum amounts and their payment procedure in Lithuania are determined by the Government. The amount of mission allowances (or daily allowances) is calculated differently, depending on the foreign country to which the employee is sent <sup>5</sup>.

When calculating the time spent by an employee on a mission, the time spent on the employee's return to and from work must also be included <sup>6</sup>. In the case when the trip from mission takes place after working hours, rest periods or holidays, the employee is entitled to the rest of the same duration on the first working day after the mission. Otherwise, such time of rest period should be added to the annual leave of the employee.

An employee of a the employer who does not belong to Lithuania's jurisdiction can be sent on a mission to Lithuania to work on a temporary basis (1) under a contract for the provision of services or performance of works concluded by the employer with a customer operating in Lithuania, and (2) to work in the branch, representative office, enterprise of the group or other place of a legal entity or (3) to work as a temporary employee.

In cases where a foreign employee sent to Lithuania is from the state that is not a member of the European Economic Area, he must obtain a work permit in Lithuania. The Lithuanian Labour Exchange deals with the issue of work permits to foreigners in Lithuania. Due to the issuance of such a permit, the employer himself intending to employ a foreign employee must apply to the division of the territorial labour exchange (within the territory of which the registered vacancy is located) operating in a specific territory of Lithuania.

<sup>5</sup> Government of the Republic of Lithuania Resolution no. 526

<sup>6</sup> Paragraph 4 of Art. 107 of the Labour Code of the Republic of Lithuania

## • Types and terms of leave

The leave according to Lithuanian Rules of Labour Laws are divided into (1) annual, (2) special-purpose and (3) extended or additional<sup>7</sup>. The employees are granted a different number of leave days depending on whether they work 5 or 6 working days a week, as well as their age, working capacity (disability), the nature of work (psychological, emotional factors, work tension, occupational risk, etc.).

Employees have to be granted with annual leave not shorter than 20 working days if the employee works 5 working days a week, and in the case of 6 working days per week – at least 24 working days per calendar year.

- The right to use annual leave by instalments arises when the employee is granted at least one day of leave. For the first year of employment, all annual leave is normally granted after a period of at least half a year from the date of conclusion of the employment contract. For the second and subsequent years of employment, annual leave is granted at any time of the working season at the request of the employee or according to the place in queue on granting annual leave drawn up at the workplace. Such a queue may be formed in a collective contract or agreement between the employer and the work council.

Meanwhile, the right to use all or part of the annual leave is lost 3 years after the end of the calendar year in which the right to full annual leave has been acquired (unless the employee was actually unable to use them).

- Special-purpose leave is granted in certain life situations. An employee can apply for special-purpose (1) maternity leave, (2) parental leave, (3) childcare, (4) educational, (5) creative and (6) unpaid special-purpose leave.
- Extended leave may be granted to employees under 18 years of age and disabled employees. If these employees work 5 working days a week, they are granted a 25-working day extended annual leave. If these employees work 6 working days a week, they must be granted a 30-working day extended leave.

However, if the number of working days of these employees per week is less (less compared to each other) or different (each week differently), the employee must be granted an extended annual leave of up to 5 weeks (calculated by weekdays and not by working days).

<sup>7</sup> Paragraph 1 of Art. 125 of the Labour Code of the Republic of Lithuania

Extended annual leave up to 41 calendar days shall be granted to the employees whose work involves greater nervous, emotional and intellectual strain and professional risk, as well as to those employees who work in specific working conditions if they work 5 working days a week. Whereas if employees work 6 working days a week, these employees should be granted annual leave of up to 50 days. However, if the number of working days of these employee is less or different per week, then extended annual leave of up to 8 weeks must be granted (calculated by weekdays and not by working days).

- **Pay for annual leave**

During annual leave, the employer must pay holiday pay (i.e. the average wage of employee for the days of leave granted).

Holiday pay is calculated according to the average wage of employee per day and paid no later than the last working day before the start of the leave (i.e., one day before the leave). Other part of the holiday pay, if it should be paid, exceeding 20 working days (which is to be paid to employees working 5 working days a week) or 24 working days (which is to be paid to employees working 6 working days a week) or 4 weeks (working different or less working days per week), are paid to the employee during his leave in accordance with the procedure and time limits for the payment of wages laid down in the employment contract<sup>8</sup>.

- **Compensation for damages in labour relations**

In accordance with the legal regulation of labour relations in force in Lithuania, each party to the employment contract must compensate for the material damage as well as non-material damage caused to the other party to the contract due to its fault by violation of its duties.

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<sup>8</sup> Paragraph 2 of Art. 130 of the Labour Code of the Republic of Lithuania

The employer can agree with employees on full material liability of employees in a collective agreement concluded between the employer and representatives of employees (collective harmonization of such conditions is possible only with representatives of employees – trade unions). In the absence of an agreement on full material liability in collective agreement, the employees are subject to application of the material liability of the limited amount provided for in the laws (in other words, not complete but limited). According to the provisions of the Lithuanian Labour Code, the amount of damages to be paid to the employer by employee is subject to limits, i.e. the employee may only be required to compensate for damage that falls within the scope of the repayable damage established in the Labour Code. As a standard, the amount to be repaid by employee (1) may amount to no more than 3 average monthly wages of employee. However, (2) if the employee causes material damage to the employer due to gross negligence, in such a case, the amount to be compensated may not exceed 6 average monthly wages of employee.

In all cases, it is relevant for employers to conclude a collective contract, since collective contract can include the agreement not only on the provision relating to full material liability. In the event there is no agreement on provisions of full material liability, it is allowed to negotiate at least increased material liability of the employee – it is possible to increase the amount of damages to be paid by the employee up to 12 of his average monthly wage.

Thus, according to the legal regulation of labour relations in force in Lithuania, the material liability can be applied for the damage caused to the employer during the labour relationship. The material liability of employees, according to the amount of damages to be paid, can be divided into:

<b>Type of material liability of employees</b>	<b>Size of damage to be compensated</b>
Limited material liability under the Labour Code	The amount from 3 to 6 average monthly wages shall be covered
Limited under the collective contract	The amount of up to 12 average monthly wages of employee is covered
Full in accordance with the law (when the damage is caused deliberately, the activity is performed with signs of crime, being drunk or intoxicated with narcotic, toxic or psychotropic substances, breach of the duty to protect confidential information and non-competing agreement, non-material damage to the employer is caused by the employee's actions)	Damage shall be compensated in full
Full under the contract (collective)	Damage shall be compensated in full

## • Procedure for recovering of damage

The legal acts provide for alternatives for the employer in order to recover the damage caused by the employee: allow deductions from the employee's wage in order to compensate for the damage caused to the employer by the employee or to apply to the labour dispute committee (or court) for the award of the respective damage.

The employer has the right to order a deduction from the employee's wage within 1 month from the day the employer became aware (or could have become aware) of such damage caused by the employee <sup>9</sup>. However, the amount of such deduction is limited. As a rule, the amount of the deduction for damages from the employee whose wage is minimal (minimum wage established by the Government) cannot exceed 20 per cent of the payable wage amount <sup>10</sup>. In case the employee's wage is higher than the minimum established by the Government, it is possible to deduct 70 percent of the amount exceeding the minimum wage <sup>11</sup>. However, such deductions are subject to limitations: the amount of the deduction may not exceed employee's average wage of one month even if bigger damage has been caused.

Where the employer seeks compensation for damage exceeding the amount of one-month wage of the employee, the employer must apply to the institutions dealing with disputes in relation law for damages. In Lithuania, labour disputes in relation to the law are examined by (1) labour disputes committee and (2) court.

## • End of labour relations

The labour relationship between the employer and the employee end upon termination of the employment contract. Such a decision may be made by mutual agreement of the parties, as well as on the initiative of one of the parties to the labour relations or due to unforeseen circumstances. According to the provisions the labour law in force in Lithuania, the employment contract may be terminated <sup>12</sup>:

<sup>9</sup> Paragraph 3 of Art. Of the Labour Code of the Republic of Lithuania

<sup>10</sup> Paragraph 4 of Art. Of the Labour Code of the Republic of Lithuania

<sup>11</sup> Paragraph 6 of Art. Of the Labour Code of the Republic of Lithuania

<sup>12</sup> Article 53 of the Labour Code of the Republic of Lithuania

- By mutual agreement between the employer and the employee
- On the initiative of the employee without important reasons
- Or due to important reasons (such as illness, retirement age, etc.)
- On the employer's initiative without the employee's fault
- Or due to the employee's fault (for example, because the employee violates the same rules of work discipline twice, does not arrive at work without any reason, etc.)
- The will of the employer
- Or in the absence of the will of the parties to the contract of employment

## • Terms of notice of dismissal

The amendments to the Labour Code which came into force in Lithuania from 1 July 2017 have established shorter terms for the notice of dismissal. The employer must notify the employee in writing (1) one month in advance if the employee works for one year and more or (2) two weeks in advance (in other words 14 calendar days in advance) if the employee works less than one year.

However, (3) these terms of notice to employees are doubled for those employees who raise a child under the age of 14 or less than 5 years are left before their retirement pension, i.e. the said employees who work for the employer up to one year - are notified in writing 28 calendar days in advance, and if they work for the employer over 1 year, they must be notified in writing 2 months in advance. Also, (4) the abovementioned basic notice periods of one month/two weeks must be tripled for employees who are disabled or who have remained in the old age for less than 2 years, i.e. y The terms for warning employees of these employees are tripled, and the employees who work for an employer up to one year are notified 42 calendar days in advance, while if they work for more than one year, they are notified three months in advance.

The provisions of the Labour Code also provide for that the termination of an employment contract is possible without giving reason by informing the employee by the written notice three working days in advance and paying him the severance pay of at least six his average monthly wages.

In the meantime, if an employee wants to terminate the labour relations, he will normally have to notify the employer in writing 20 calendar days or 5 working days in advance, if the employment contract is terminated for important reasons.

The Lithuanian legal system for labour relations also provides for certain restrictions on termination of employment contracts <sup>13</sup>:

<sup>13</sup> Paragraph 1-4 of Art. 61 of the Labour Code of the Republic of Lithuania

- An employment contract with a pregnant employee during her pregnancy and until her child reaches the age of four months may be terminated only by agreement of the parties, on her initiative, on her initiative during the trial period, in the absence of the will of the parties to the contract of employment, as well as when the fixed-term employment contract expires at maturity
- With employees raising a child (adopted child) of up to 3 years of age, an employment contract may not be terminated on the initiative of the employer if there is no fault of employee
- The employment contract with employees on maternity, paternity or parental leave cannot be terminated by the employer's will;
- It is prohibited to dismiss an employee called for compulsory military service or an alternative national defence service on the initiative of the employer in the absence of the employee's fault or by the employer's will.

## • Severance Pays (compensations)

The amount of severance pay (compensation) payable to employees decreased significantly in Lithuania from 1 July 2017. Such changes make the system of Lithuanian labour law relations more attractive to employers, as they are no longer burdened by such a large amount of severance pays (compensations) to be paid to dismissed employees.

In the past, dismissed employees had to be paid the severance pays from 2 to 6 average monthly wages. Today, the severance pay rates range from half to two average monthly wage sizes (only in exceptional cases a severance pay of 6 average wages, when the employment relationship is terminated promptly by notifying the employee 3 working days in advance is paid). Consequently, shortened notice periods and reduced severance pays make it easier to start and implement changes in the labour relations often needed in business. Severance pays to employees are paid considering their continuous work experience at the workplace:

- In the case if the employee works for an employer less than one year, he shall be paid a severance pay of his half average monthly (half month) wage
- If the employee works for the employer for one year and more, he is paid a severance pay amounting to his average wage of two months
- Irrespective of the length of experience of an employee, and dismissal of an employee without any valid reason (he must be notified in writing three working days in advance) - he is paid a severance pay amounting to his average wage of at least six months

The employees may also be paid a long-term work allowance based on the continuous work experience of that employee in one workplace (where the relationship between the employee and the employer lasts for at least five years). However, this additional allowance is not paid from the funds of the employer, but from the Long-Term Work Allowance Fund. An employee, on his own initiative, must apply for such an allowance in writing to this fund requesting to allocate such allowance.

## • Procedure for payment of severance pay

At the end of the employment relationship, i.e. after the termination of the employment contract, the employer must pay the employee all allowance related to the employment relationship, which means that not only the wage for that day must be paid, but also the compensation for unused leave days, as well as the severance pay (if any) and other employment-related allowances, if any, depending on the type of work, agreements between the employer and the employee, etc. The employer must settle with the employee on the same day when the employment contract is terminated, but not later than the end of the actual employment relationship.

The provisions of the Lithuanian Labour Code allow the employer and the employee to agree in writing on the extension of such settlement term: if the parties agree in writing, it is allowed to extend the settlement term to up to 10 days. However, if the employer fails to settle with the employee on time, the employer shall be subject to sanctions. In such a case, the employee may apply to Lithuanian state institutions dealing with individual labour disputes with a request to award not only unpaid amounts related to labour relations, but also to demand compensation for delay in timely settlement with him. Disputes of this nature are dealt with by the Labour Dispute Committee of the State Labour Inspectorate of the Republic of Lithuania.



# Lithuania | REAL ESTATE

The concept of real estate in Lithuania includes the land, parts of land, including air over it and land under it, as well as the buildings. Construction sector, as well as organizations or companies founded by persons to manage their real estate as optimally as possible are closely related to real estate.

## • Requirements for the transaction

The parties to the contract on sale and purchase of real estate may be any entities of civil law, i.e. natural persons or legal entities of the Republic of Lithuania and foreign countries, except for the exceptions provided for by law regarding the acquisition of land parcels.

In Lithuania, a contract for the purchase-sale of an immovable thing shall be subject to notarial certification <sup>1</sup>, regardless of whether the transaction involves a natural or legal person. The non-compliance with the notarial certification of the contract invalidates the contract. The requirement of a notarial certification for the contract on purchase and sale of real estate makes the contracts on purchase and sale of real estate complicated, and results in additional costs since the services provided by a notary should be paid.

The essential terms and conditions of each contract on purchase and sale of real property are the subject of the contract <sup>2</sup> (the thing to be sold/purchased and its quantity is indicated) and the price of immovable thing <sup>3</sup>. Each contract on sale and purchase of immovable thing must contain the following data describing the immovable thing: the type of immovable thing (land parcel, building, facility, etc.), address, total area, main purpose of use, unique number in the public register. If a land parcel is being bought, the cadastre number of the land parcel should also be indicated. If these conditions are not indicated in the contract on sale and purchase of immovable thing, the contract is deemed not to have been concluded. Although the price of immovable thing is fixed by agreement between the parties <sup>4</sup>, the parties, when fixing the price, must take into account the value of the immovable thing to be purchased on the market since by the contract on sale and purchase, they intend to obtain a monetary equivalent corresponding to the value of the thing, and therefore, the price, clearly not corresponding to the value of the thing

<sup>1</sup> Paragraph 1 of Art. 6.393 of Civil Code of the Republic of Lithuania

<sup>2</sup> Art. 6.396 of Civil Code of the Republic of Lithuania

<sup>3</sup> Art. 6.397 of Civil Code of the Republic of Lithuania

<sup>4</sup> Paragraph 1 of Art. 6.313 of Civil Code of the Republic of Lithuania

contradicts the nature of the transaction to be repaid and the principle of reasonableness. Such a price is the basis for challenging the contract on immovable thing due to the real will of the parties to the contract.

## • Taxes associated with the purchase and sale of real estate

When selling real estate in Lithuania, a 15% of income tax of individuals is applied. This tax will be calculated as the difference between the incomes from the sale of the real estate and the acquisition price of the property, together with the deduction of compulsory payments made for the purchase of this property and the costs of repairing this property. Such a restriction eliminates the possibility of avoiding the resale of real estate caused by the income tax of individuals. The Law on Personal Income Tax provides for cases when it is not necessary to pay income tax on the sale of real estate:

- If such property was acquired or inherited 10 years before <sup>5</sup>
- If the property is sold at a lower price than the acquisition price (value)
- If the housing for 2 years was the place of residence of the individual declared (applied only when selling flats, residential houses) <sup>6</sup>
- If the housing for 2 years prior to the sale was the place of residence of the individual declared, but within one year of the sale of this housing he buys and declares his place of residence in the other housing, he does not need to pay taxes on the sale of housing (applies only to the sale of flats, residential houses) <sup>7</sup>

Land tax is levied on private land owned by the natural and legal persons in the Republic of Lithuania, with the exception of forest and agricultural land, where the forest is planted in accordance with the procedure established by laws and other legal acts of the Republic of Lithuania. Land tax is paid annually and is calculated in accordance with the rates established by the government. Land tax rates depend on the location of real estate in the territory of the municipality and range from 0.01% to 4% of the taxable value of the land.

The object of the real estate tax is immovable thing located in the Republic of Lithuania. The real estate tax rate, ranging from 0.3% to 3% of the taxable value of the real estate, is determined by the municipalities taking into account one or more of the following criteria: the purpose, use, legal status of the immovable thing, technical characteristics thereof, the state of maintenance, categories of taxpayers (size or legal form, social status) or the location of the immovable thing. Non-taxable part of the property – property worth EUR 220 000.

<sup>5</sup> Clause 1, paragraph 1 of Art. 17 of Law on Personal Income Tax of the Republic of Lithuania

<sup>6</sup> Clause 53, paragraph 1 of Art. 17 of Law on Personal Income Tax of the Republic of Lithuania

<sup>7</sup> Clause 54, paragraph 1 of Art. 17 of Law on Personal Income Tax of the Republic of Lithuania

- **Joint community property**

A joint community property right is exercised when the parts of the ownership of each owner in the joint community property are defined, and the joint community property ownership is when the parts of ownership are not explicitly defined (for example, all property is presumed to be joint community property of spouses property shall be presumed to be joint community property and the shares belonging to them are not indicated separately).

Joint partial community property may be of two types, respectively. First, parts of co-owners can be expressed in partial terms (e.g. 50 percent, 1/3 and 2/3, equal, etc.) or by determining the parts of the thing belonging to them (for example, in the case of a residential housing property, different rooms belong to different co-owners).

In practice, there are a number of disputes between co-owners in relation to the use of joint community property. If the co-owners disagree about the procedure for the use of their property, it shall be determined by the court at the request of one of the co-owners. It is also possible to partition a share of the joint common property judicially. In this way, the thing is divided and the relationship of co-owners ends.

- **Priority right of co-owners to buy shares held in co-ownership**

The seller of a share commonly owned shall inform the other co-owners in written form about the intention to sell his part to others than the co-owners, indicating the price and other conditions of sale <sup>9</sup>. When a share of an immovable thing commonly owned is sold, such information shall be given through a notary. When the other co-owners renounce their priority right to buy the share or fail to use such right to the immovable thing within one month, and to other thing, within ten days from the day of receipt of such notification, provided the co-owners have not agreed otherwise, the seller shall have the right to sell his share to any person. The social purpose of this legal norm is to create conditions for the ending of the co-ownership, since it is always preferable when the owner of the thing is one person; on the other hand, this requirement restricts the right of a person to choose freely a buyer of immovable property. The problematic application of this requirement arises from the fact that the right of pre-emption is valid only when concluding a sale and purchase contract, and in the cases of transfer of other share of property (exchanges, donations, etc.) does not apply. For example, a person can transfer a share of the

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<sup>9</sup> Art. 4.79 of Civil Code of the Republic of Lithuania

property to the company as a shareholder's contribution and then sell the company's shares that have become more expensive. Also, a person can falsely donate/exchange the thing and reclaim the benefits of the transaction by other means. Thus, the pre-emptive right of co-ownership is avoided. Such a wording of the law in practice raises a number of disputes where the transactions concluded by the co-owner are sought to be declared void motivating that transactions are concluded only "for show".

## • Real Estate Servitudes

In practice, situations arise where the use of an immovable thing of another is inevitably required in order to use real estate according to its purpose (in most cases, land parcel). In this case, a person may apply to the owner of that thing and enter into a servitude transaction or apply to the court and demand the establishment of the servitude <sup>10</sup>. A servitude is a right in respect of an immovable thing of another that is granted for the use of that thing (the servient thing) or a restriction of the right of the owner of that thing in order to ensure a proper utilisation of the thing in favour of which the servitude is established (the dominant thing) <sup>11</sup>. This is property in rem, which "follows the thing". If a subject of ownership of a servient or a dominant thing changes, the servitude fixed remains. Servitude provides the servitude holder with specific rights to use particular thing of another or withdraws specific rights to use that thing from the servitude holder, and therefore the determination of the land servitude is to be regarded as the transaction of restriction of the immovable thing. Such examples can be the use of the land parcel of another for access to the public road, resting of one building structure onto another belonging to other owner's immovable thing. Since the servitudes restrict the rights of the owner of the servient thing, such a person may claim a fair remuneration for the restraint of his property rights. Such questions are usually resolved in courts, but can also be determined by transactions. Servitudes are compulsorily registered in the Register of Real Estate; therefore, the servitude fact is public.

## • Litigation on Real Estate

In Lithuania, claims for tangible rights to real property, regarding use of real property (except for applications regarding distribution of spouses' property in the cases of dissolving marriages, regarding recognising seizure on real property to be void) shall be under the jurisdiction of a court in the same location as the real property or the main part thereof <sup>12</sup>.

<sup>10</sup> Art. 4.124 of the Civil Code of the Republic of Lithuania

<sup>11</sup> Art. 4.111 of the Civil Code of the Republic of Lithuania

<sup>12</sup> Art. 31 of the Code of Civil Procedure of the Republic of Lithuania

## • Types of Land Use

According to the main target purpose of land use, the Land Fund of the Republic of Lithuania comprises:

- Land for aquaculture purposes is the land used or suitable for the use in the production of agricultural products, including the areas built-up with residential buildings and outhouses owned by the land user, as well as forest areas and water bodies on the land parcel
- Land for forestry purposes is the land occupied by the forested area (stands), as well as cleared areas, perished stands, nurseries, forest roads, sections, technological and fire-prevention strips, timber storage points, other facilities and equipment related to forest, leisure sites, game feeding points, land designated for afforestation purposes, other land use located in between the forest land, including agricultural lands
- Land for other purposes is the land classified into the types of parcels by their method of the use specified in the territorial planning documents: residential, public areas, common use, industrial and warehousing, commercial facilities, engineering infrastructure areas and for the exploitation of mineral resources, storage of waste, national defence and other purposes.
- Land for conservation purposes is the land of protected territories, which includes reserves, land parcel occupied by cultural heritage objects

Construction may only be permitted if the use of land is agricultural (on the basis of a rural development project of a farmer's farmstead) or on other land. Persons in Lithuania are obliged to use land according to the main purpose of its use, and if persons do not comply with this requirement, they may be held liable.

## • Restrictions on the purchase of the land for agricultural purposes

The land for agricultural purposes is a special object of ownership, the acquisition of which is strictly regulated by the legal acts of the Republic of Lithuania.

In Lithuania until 2014, the restrictions were imposed on foreigners regarding the acquisition of the land of agricultural purposes in Lithuania. Such restrictions have attracted the attention of the European Union institutions, as they are contrary to fundamental principles of the European Union - restrict the investments in the

land of agricultural purpose, and thus violate the free movement of capital. In 2014, the amendments to the Law on the Acquisition of Agricultural Land were adopted, laying down somewhat softer restrictions. However, the European Union does not consider such changes to be sufficient, and claims are made against Lithuania for non-compliance with the requirements. At present, draft amendments to the law are being prepared, with the aim of mitigating restrictions on the acquisition of the land for agricultural purposes by foreigners.

The possibility of acquiring land of agricultural purposes, after the entry into force of amendments to the law in 2014, appeared only for those foreign entities that meet the criteria for European and transatlantic integration. The entities complying with such criteria are foreign legal persons, as well as other foreign organizations established in the countries of the European Union or the countries, which have concluded the European Agreement (Association Agreement) with the European Communities and their member states in the countries of the Organization for Economic Co-operation and Development, the North Atlantic Treaty Organization (NATO members and states participating in the Agreement on the European Economic Area, citizens of specified states and permanent residents of these foreign states, as well as permanent residents of the Republic of Lithuania, who do not have citizenship of the Republic of Lithuania. Citizens of other countries (such as Russians, Byelorussians), whose situation has remained the same as before the end of the aforementioned transitional period and the entry into force of the new Law, are not included in this circle of subjects.

Currently, only up to 10 hectares of the land for agricultural purposes can be acquired in Lithuania without restrictions. A larger area of the land from the state and private owners can be acquired by the persons or companies already engaged in agricultural production for at least three years. The period of studying or learning when acquiring agricultural education is also included in this period<sup>13</sup>.

A legal entity or another organization seeking to acquire a parcel of the land for agricultural purposes must have carried out agricultural activities and declared landed property and crops for at least 3 years during the last 10 years before the date of conclusion of the transaction on the acquisition of the land for agricultural purposes. In addition, the income from agricultural activities must account for more than 50% of the total income received, and economic viability must be proved by assessing the prospects of this person in accordance with the procedure established by the Ministry of Agriculture of the Republic of Lithuania.

It is worth pointing out that, even if the foreigners were prohibited from acquiring the land for agricultural purposes in the Republic of Lithuania, the latter found

<sup>13</sup> Art. 2 of the Law on the Acquisition of Agricultural Land of the Republic of Lithuania

ways to circumvent imperative prohibition of the law and acquired the land for agricultural purposes indirectly through intermediaries or establishing a legal entity by acquiring shares of a legal entity. These methods after the amendments to the law have entered into force in 2014 remained relevant to those foreign entities that do not meet the criteria of the European and transatlantic integration mentioned above.

Another restriction on the purchase of agricultural products is related to the amount of acquired land and applies jointly to the citizens of the European Union and Lithuania. A person or related persons can acquire insomuch land in the territory of Lithuania that the total area of their agricultural land purchased from the state would not exceed 300 hectares. A person or related persons may acquire such quantity of land on the territory of Lithuania that the total area of agricultural land belonging to them and acquired from the State and other persons does not exceed 500 hectares. Related parties are considered the spouses, parents (adoptive parents) and their minor children (adoptees), as well as legal persons who control 25% of the shares of the other legal entity that acquired the state land, or a natural person who controls 25 % of shares of the legal person who acquired the state land <sup>14</sup>.

Acquisition of the land for agricultural purposes in Lithuania is a complicated process, since there are many criteria that foreign citizens or organizations must meet; therefore, in order to implement this right, it is recommended to apply to professional persons for the provision of legal services.

It should be noted that after the acquisition of land for agricultural purposes, it is compulsory to carry out the agricultural activity on it, and the legal entity who does not comply with this obligation can be held liable.

- **Taking land for public needs**

When the land in the Republic of Lithuania is recognized as necessary for meeting the needs of the public, and this land belongs to private persons, the National Land Service under the Ministry of Agriculture adopts a decision on the land parcel to be taken from landowners. On this basis, a lease or land for use contracts of private land shall be terminated before the deadline. When a private land parcel is taken for public needs, the land owners and/or other user must be fairly remunerated:

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<sup>14</sup> Art. 3 of the Law on the Acquisition of Agricultural Land of the Republic of Lithuania

- In case a private land parcel is taken for public needs, the land owner and/or another user must receive a fair compensation in cash amounting to the market price, or, upon a written agreement of the owner of the land, he is given a parcel of a state-owned land adjacent to the taken land parcel for public needs
- The value of plants within this land parcel taken for public needs, the volume of timber, the lost harvest and invested funds for growing of agricultural production and afforestation, the amount of losses that were incurred due to taking of the land parcel for public needs as well as structures and facilities constructed or being constructed on that parcel, and the plants growing therein for public needs shall be compensated to the land owner or another user

Most of the disputes about land taken for public needs arise precisely because of the fair compensation for the property being taken. Faced with the procedure for taking an immovable property for public needs, landowners often disagree with the proposed compensation for property being taken by the public need and are inclined to raise litigious disputes over the established incorrect remuneration for the property taken for public needs. The main evidence in the cases of compensation for land taken for public needs is the property valuation report or an act of examination of property valuation. The value of land taken for public needs is to be determined on the day when a decision is adopted to take the land for public needs. The value of property is usually determined by the price of identical or similar property transfer transactions.

## • Legal registration of immovable property

Newly formed parcels and newly erected buildings in Lithuania are registered in the Public Register of Real Estate. The changes of the owners of the land parcels and buildings are registered in the Public Register of Real Estate as well. The amendments to the legislation providing for the mandatory registration of buildings came into force only in 2015. The amendments aimed at encouraging persons to complete the construction started and validate them both by construction completion acts and their registration in the Register of Real Estate.

After completion of construction procedures, the building and property rights to it must be registered in the Register of Real Estate not later than within 3 months from the date of receipt of the act on completion of construction, the date of approval and registration of the declaration of completion of the construction or the date of signing the declaration of completion of construction (when it is not approved and not registered)<sup>15</sup>. An unfinished or reconstructed building must also



be registered in the Register of Real Estate at the latest within 3 years from the commencement of construction. Such changes limit the ability of real estate owners to avoid paying taxes or conceal the value of their property.

## • Construction of real estate (real estate development)

All buildings in Lithuania are classified as immovable property. The construction sector is one of the largest and most important branches of Lithuanian economy. The construction sector accounts for about 10 percent of the national gross domestic product. Due to this, from a legal point of view, the construction in Lithuania is a wide area; the legal regulation of construction is exhaustive.

The main legal acts regulating construction in Lithuania are the Technical Regulations for Construction. They specify the detailed requirements for the construction works, i.e. permissible dimensions of the building, distance to other structures, materials that can be used in construction, etc. The biggest problem with technical regulations for construction is the high volume of them (for example, currently 64 technical regulations for construction are in force), which is growing, the technical regulations for construction as well as their names are often modified.

In Lithuania, the problematic aspect of construction has long been the responsibility of persons involved in construction to the purchaser of real estate. There was a lack of guarantees given to purchasers, responsibility for improper quality of construction was not regulated sufficiently and the circle of responsible persons was very narrow. Considering this fact, in 2017, the legal regulation regarding the responsibilities of the persons engaged in the construction and the persons participating in them has changed. For a long time, the general contractor was the main responsible person for construction according to the law, but in practice, the purchasers of real estate used to ask whether they could contact the contractor directly relating to the removal of defects. It was explained that it was necessary to contact the seller, who would require the contractor to rectify the defects. The amendments<sup>15</sup> to law that entered into force in 2017 provide for that the purchaser may directly contact the contractor and demand that the defects should be removed, for he is liable as a person who carried out the construction works and is obliged to provide legal guarantees for the result of his work. In addition, the amendments provide for the liability of the joint liability of the builder (real estate developer) and the contractor for defects revealed during the warranty period. This means that, after having revealed the defect, purchasers of housing can also contact the seller (the real estate developer) within the warranty terms. The terms of the

<sup>15</sup> Paragraph 5 of Art. 28 of the Law on Construction of the Republic of Lithuania

<sup>16</sup> The Law on Construction of the Republic of Lithuania

warranty provided by the contractor are five years; ten years, in existence of hidden constructions of the structure (structures of construction works, pipelines, etc.); twenty years, in existence of intentionally concealed defects <sup>17</sup>.

In addition, the amendments introduce new requirements for security of performance of obligations during the warranty period. It has been established that the contractor must provide security of obligations and specify his minimum size (five percent of the price of the construction of the building) and the expiry date (the first three years of the warranty period of the building). The developer of a real estate must provide the purchaser of a building (part thereof) with security of performance of obligations for the failure of contractor to fulfil improperly fulfil his obligations during the warranty period, which corresponds to the requirements for securing the obligations submitted by the contractor. Such changes have extended the guarantees to the purchaser of real estate and increased the method to demand responsibility from responsible persons for construction defects.

## • Construction permit

In Lithuania, a construction permit for construction works is a mandatory document. Construction without permission is punishable by a fine provided for in the laws, a suspension of construction and possible demolition of buildings if the construction permit is not obtained after the suspension of illegal construction. In order to obtain a construction permit, a digital version of a ready-made house project must be placed on a common information platform. After placing the project on the website, the representatives of the municipality and other interested institutions verify the project. If the design solutions are appropriate, all institutions approve the project and the municipality issues a document allowing the construction. If any of the institutions have comments on the project, those comments will be submitted to the designer and the latter will have to take decisions on the revision of the project in the light of the content of the comments.

Whether the building permit is needed or not is determined by the number of inhabitants in the settlement. If the land parcel is located in a regional park, protected area, water protection zone or in another publically sensitive area, the harmonization period related to the construction permit is long, and the process itself is complicated. Construction permit is not required for individually built structures up to 80 square meters, including a summerhouse, sauna, etc. (if the land parcel is not located in a protected area or city).

<sup>17</sup> Art. 6.698 of Civil Code of the Republic of Lithuania

## • Gardeners' societies

Owners of land parcels belonging to the territory of gardens can rally gardeners' societies. In general, the gardeners' society is very similar to the association of the owners of multi-apartment residential building, which is a legal entity (a simple organization or company), which is entitled to engage in activities related to the maintenance of the land for general purposes, use of buildings and facilities for general purposes (fences, gates, resting areas, beaches, forests, water bodies, etc.) and general engineering facilities. Having established the gardeners' society, the fees to be paid are optimized, the owners of land parcels are involved in the decision-making procedures regarding the land for general use, engineering buildings, equipment; the decision-making procedure becomes faster and more professional.

## • Lease of state land parcels

In Lithuania, state-owned agricultural land parcels are leased to natural persons and legal entities of the Republic of Lithuania and foreign countries or other foreign organizations for a maximum period of 25 years. Leasing of state-owned agricultural land parcel is an alternative to foreign nationals or legal entities that do not comply with the requirements specified in the Law on the Acquisition of Agricultural Land (as already mentioned above, the persons or companies that have carried out agricultural activities for at least three years already can acquire the land plot bigger than 10 ha)<sup>18</sup>.

## • Lease of premises

The lease agreement in Lithuania for a term longer than one year must be in writing. A lease of immovable things concluded for a term longer than one year may be used against third persons only if it is registered in the public register in accordance with the procedure established by laws. The lease agreement may be of a fixed or indefinite duration, but in all cases the term of the agreement may not exceed one hundred years. The term of the lease agreement is determined by the agreement of the parties. If the term of the agreement is not specified thereafter, the lease agreement is considered to be termless. If, after the expiry of the term, the lessee continues to use the property for more than ten days, and the lessor does not object to this, the agreement is considered to be termless. The lessee, who has performed the duties taken in accordance with the lease in an orderly manner, has the

<sup>18</sup> Art. 2 of the Law on the Acquisition of Agricultural Land in the Republic of Lithuania

<sup>19</sup> Art. 6.497 of the Civil Code of the Republic of Lithuania

right of priority to renew the agreement after the termination of the agreement comparing with the other persons.

The agreement may be terminated before the deadline on the lessor's initiative and in accordance with the laws of the Republic of Lithuania, and the lessee is evicted only in the following cases <sup>19</sup>:

- The lessee deliberately worsens the condition of premises
- The lessee delays the payment of the rent or the cost of the provided utilities under the agreement for more than thirty calendar days
- The premises are not used for the purpose specified in the agreement

The lessee shall have the right to bring an action to a court for dissolution of a contract of lease before time <sup>20</sup>:

- If the lessor does not do the repairs that he must do
- If the lessor does not transfer the thing to the lessee, or hinders the use of the thing according to its purpose and terms of the agreement
- If the thing becomes unusable due to the circumstances beyond the control of the lessee
- If the transferred thing is defective, which the lessor has not discussed and this fact was not known to the lessee, and due to these defects the thing cannot be used according to its purpose and terms of the agreement

If the lease agreement is for an indefinite period, both parties shall have the right to terminate the agreement at any time by giving notice to each other one month before the termination, and in case of lease of immovable things – three months before the termination. The lease agreement may also specify longer notice periods.

Legislation in Lithuania provides for the lessee to sublease the leased thing only with the written consent of the lessor <sup>21</sup>.

<sup>20</sup> Art. 6.498 of the Civil Code of the Republic of Lithuania

<sup>21</sup> Art. 6.490 of the Civil Code of the Republic of Lithuania

- **Restoration of ownership rights of the citizens of Lithuania to the existing immovable property**

In view of the historical events - the occupation and forced accession of the Republic of Lithuania to the USSR, a unique institute for the regulation of restitution relations and implementation of the restoration of ownership rights has been established in Lithuania. According to the laws of the USSR (LSSR), the real estate of a large number of Lithuanian citizens was nationalized or otherwise illegally expropriated, and therefore, after regaining of Lithuania's independence, the citizens of Lithuania were granted the right to restore property rights to expropriated immovable property.

- **Acquisitive prescription of real estate**

In Lithuania, a physical or juridical person who is not the owner of a thing but has acquired the thing in good faith and has possessed it in good faith, legitimately, openly, continuously as his own immovable thing for at least ten years, when during the entire such period the owner of the thing had the legal possibility to implement his rights to the thing, but has not used them once, shall acquire ownership right to such thing <sup>22</sup>. The fact of acquisition of ownership by acquisitive prescription shall be established by court. Ownership by acquisitive prescription shall not apply to things obtained by force or in a clandestine manner, irrespectively of whether the person who has obtained the thing by force or in a clandestine manner way himself or somebody else seeks to acquire ownership right in this manner. Acquisitive prescription shall not apply to ownership right to things that are property of the State of a municipality, or things registered on another person's (not the possessor's) name. A person acquiring property by acquisitive prescription must act not only in good faith, that is, by possessing the thing he must be convinced that nobody else has more rights to the thing he is, but he must also remain a possessor in good faith during the entire period of acquired prescription, and even upon acquiring the thing in ownership he must not know about impediments that hinder his acquiring the said ownership, if such impediments existed.

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<sup>22</sup> Article 4.68 of the Civil Code of the Republic of Lithuania



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Portugal

Sousa Machado, Ferreira da Costa & Associados



# Sousa Machado, Ferreira da Costa & Associados

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Portugal

## General information

The law firm Sousa Machado, Ferreira da Costa & Associados, Sociedade de Advogados ("SMFC") was founded in 1991 by 4 partners and now comprises the 4 founding partners, 8 associates and 5 trainee lawyers. SMFC offers legal advisory services particularly in the following practice areas:

- Business law, including commercial law
- Labour law and commercial contracts
- Civil law in general and in particular civil contracts
- Law of obligations (contract)
- Insurance law
- Family and inheritance law
- Litigation, pre-litigation and debt recovery, notably in areas of mobile telecommunications
- Credit insurance and motor vehicles (financial lease contracts)
- Chemical, agri-foodstuffs, pharmaceutical and cosmetics, etc. industries

### 📍 Head Office

Rua Castilho, 5 – 4º 1250-066  
Lisboa, Portugal

☎ +351 21 092 48 00

☎ +351 21 385 48 15

alo@smfcnet.com

www.smfc.pt

# Portugal | CORPORATE LAW

## • Framework

The most relevant legislation to companies in Portugal is:

- The Commercial Code ("Código Comercial", dated 1888)
- The Portuguese Companies Code ("Código das Sociedades Comerciais", Decree law no. 262/86, dated September 2, as further amendments)
- The Portuguese Securities Code ("Código dos Valores Mobiliários", Decree law no. 486/99 dated November 13, as further amendments)
- Several specific laws and regulations

## • Corporate structures available

There are four types of corporate entities available in Portugal: general partnership companies (*sociedade em nome colectivo*), private limited liability companies (*sociedade por quotas*), public limited companies (*sociedade anónima*) and limited co-partnership companies (*sociedade em comandita*).

European Companies (*Societas Europaea*) may be incorporated in Portugal, provided that they have their registered office in Portugal or if they are participated by companies governed by Portuguese companies law.

Notwithstanding, the three most common legal structures that may be considered when envisaging the settlement of a business or activity in Portugal are the following:

- Representation office or branch
- *Sociedade Anónima* (SA)
- *Sociedade por Quotas* (Lda.)

### BRANCH

A branch is merely a permanent representation of a foreign company, organized to conduct the business outside its original country. It differs from a company due to the following characteristics:

- The branch is not legally independent from the head-office, while a subsidiary company operates as a different legal entity
- The branch shall appoint a legal representative to manage the business, while limited liability companies must appoint members of the corporate bodies (management body and an audit body).

The procedure for registering a branch in Portugal is simple and consists mostly on the submission of a resolution from the head-office and other documents evidencing the legal existence of the foreign company.

## COMPANIES

SAs and Lda.s differ from other structures available where the shareholders' liability is unlimited (*sociedade em nome colectivo and sociedade em comandita*), although the latter are rarely used nowadays.

When deciding what legal form the subsidiary should assume, the foreign investor must take into consideration the differences between a SA and a Lda., which may influence significantly their business operations. From a day-to-day point of view, the two can be managed in broadly similar terms, although Lda.s may in some cases be less formally managed due to the fact that they comprise a lighter corporate structure, hence being more appropriated for short-term investments. As for SAs, they are usually recommended for enduring investments, especially where a large number of investors is envisaged.

- **Share Capital**

*The minimum share capital for a SA is € 50,000.00, of which at least 30 percent must be fully paid up until the date of incorporation.*

The statutory capital for a Lda. is freely set in the articles of association of the company and will correspond to the sum of the quotas subscribed by the quota holders. However, it is not possible for this value to be below the minimum nominal value of the quota set by law, which is € 1.00 (one euro). The Portuguese Law also allows the quota holders to decide to pay the value of each quota on the date of incorporation or at the end of the first economic year.

Under general Portuguese Companies Law, a S.A. must have at least five founding shareholders. Conversely, a Lda. must have at least two shareholders unless it adopts the structure of a single quota holder company (*sociedade unipessoal por quotas*) in which case the share capital is totally held by a sole quota holder.

## • Shares and quotas

The share capital of a SA is divided in shares, these can either be nominal or without nominal value (but both cannot coexist in the same SA), furthermore, all shares must have the same nominal value (of no less than € 0,01 per share). Share certificates are issued to represent one or more shares in accordance with the Company's by laws.

Shares are nominative and transferred by endorsement statement signed by the transferor on behalf of the transferee and the correspondent registration with the Company (or the financial institution, if applicable).

Each class of shares must have something that makes it different from the other classes and all the shares within one class must confer the same rights. Common (“ordinárias”) shares are the securities that represent ownership in a corporation. Holders of common shares exercise control by electing the management board and voting on corporate policy. Preferred (“preferenciais”) shares bestow some sort of rights and privileges upon common stock. The nature of these rights or privileges shall consist of patrimonial advantages (mainly concerning dividends).

The share capital of a Lda. is divided in quotas, which can have different nominal values with a minimum of € 1,00. Quotas are not materialized in a document and its transfer must be executed by written agreement, followed by the respective deposit with the Commercial Registry Office.

## • Liability of shareholders

In both SAs and Lda.s, the liability of each shareholder is limited to the nominal value of his interest in the company. However, the quota holders of a Lda. are joint and severally liable for any unpaid capital contributions foreseen in the company's by-laws.

## • Corporate Governance

SAs management and supervision bodies' composition depends on the organization system adopted, which may be organized either on (i) a traditional 2-tier structure consisting of a Board of Directors (or a sole Director, should the share capital not exceed € 200,000.00) and an Audit Board or a Single Auditor; or (ii) under a 1-tier structure consisting of a Board of Directors, which shall comprise an Audit Commission and a Chartered Accountant; and (iii) under a 3-tier structure consisting of an Executive Board of Directors, a General and Supervisory Council and a Chartered Accountant. SAs with a capital not exceeding € 200.000,00 may have only one Director instead of a Board of Directors.

The corporate bodies of a Lda. are the General Meeting of Shareholders and the Management (which may be composed of one or more directors). Although a Supervisory Board is not mandatory, in some situations Lda.s are required to appoint a statutory auditor.

### GENERAL MEETING OF SHAREHOLDERS

Although most powers to run the company are vested in the directors, the following resolutions are reserved to the Shareholders:

- Approval of financial statements and distribution of profits
- Appointing and removal of the Directors and members of the Audit Board
- Amendments to the Bylaws
- Merger, spin-off, transformation or dissolution of the company
- Transfer and encumbrance of real estate properties (only applicable to Lda.s)
- Issuance of Preferred Shares
- Issuance of Bonds
- The division and consent for the transfer of quotas to third parties (only applicable to Lda.s)

#### Quorum Majority\*

SAs	Quorum	Majority
First call	No quorum or 1/3 for matters comprising the changing of articles of by-laws, merger, spin-off, transformation or dissolution	Majority of votes cast or 2/3 for matters comprising the changing of by-laws, merger, spin-off, transformation or dissolution
Second call	No quorum	Majority of votes cast or, for changing the matters described above, 2/3 of the votes cast or simple majority if at least 50% of the share capital is present or represented

\* Certain resolutions may require unanimous vote or other majority according to the company's Bylaws.

Lda.s	Quorum	Majority
	No quorum	Majority of the votes cast or 3/4 of the share capital for matters comprising the changing of by-laws, merger, spin-off, transformation or dissolution

## DIRECTORS

SAs are required to have a board of directors (or an Executive Board of Directors and a General and Supervisory Council, depending on the organization structure adopted).

Lda.s are managed by one or more directors (“gerente/gerência plural”), although there is not a formal management board.

Managing corporate bodies of SAs and Lda.s have very broad authority to bind the company. Although restrictions may be contained in the by-laws, these are not enforceable against third parties provided the actions of the directors are within the limits of the corporate purpose.

In a SA, the shareholders appoint the board of directors, generally for a four-year term (but the by-laws can provide for a shorter term). There are no requirements for independent directors (except for listed companies). In a Lda., the directors may be appointed for terms of office or without a definite term, in this case remaining appointed until dismissal or resignation. The directors may be remunerated or not.

## • Annual Accounts

Portuguese law foresees that all companies must approve, at the annual general meeting, the respective year-end accounts within a 3-months period (as from the end of the financial year) and, in special cases, within a 5 months period (in case of companies with consolidated accounts).

The documents to be approved are: (i) the year-end financial statements (comprising a detailed balance sheet), (ii) the management report, (iii) a report issued by the audit body, and (iv) in case of SAs, a legal certification of the accounts must be issued by a Chartered Accountant.

Once approved by the general meeting, the accounting documents must be submitted, by Internet, under a new system called “*Informação Empresarial Simplificada*” (IES), under which the annual financial and accounting information is sent simultaneously to all the relevant public services (tax authorities, commercial registrar, etc).

In case of permanent representations of foreign companies in Portugal (Branches), the process is even easier, as it is only required a declaration confirming that the head-office received the supporting documents of the branch’s accounts.

## • Incorporation of a company

The incorporation of a company (except when depending on special approvals or when the start-up capital is to be made through contributions in kind) may be fully performed in one day, if the shareholders choose to create a company under the special regime that allows a company to be incorporated “in one hour” (on the spot company – “*empresa na hora*”), with or without acquiring or possessing a trade mark. This process is carried out before a Commercial Registry Office or a Company Formalities Centre (CFE).

On the other hand, it is now possible to launch and set up a company throughout digital means – the so-called “online company registration”.

Regarding the special regime of incorporation “on the spot company” above mentioned, in April 2008, it was also created a special regime that allows a branch from a foreign company to be fully incorporated “in one hour” (on the spot branch – “*Sucursal na hora*”). With this procedure it can be created, immediately and in one place, permanent representations of foreign companies in Portugal, with the simultaneous appointment of their representatives.

In 2008, some measures were approved to simplify the companies’ incorporation process as well as other companies’ day-to-day procedures, namely:

- **Company's Card** ("*Cartão da Empresa*"): as from now on, Companies shall have a sole Identification Card that evidences the three essential numbers: the Company's Tax Identification Number, the Company's number of registration at the Commercial Registry Office and the Company's Social Security number. The Company's Card may be requested online ([www.empresonline.pt](http://www.empresonline.pt)) or at the Commercial Registry Office, remaining the respective issuance dependent on the enrolment of Company with the Tax Authorities and with the Social Security.
- **SICAE** (Portuguese Information and Classification System of Economic Activities): this system consists on a permanent and actualized database concerning the companies "economical activity code" ("CAE"), allowing a simplified process of modification regarding this matter.

## • Listed companies

Listed companies have to comply both with the Portuguese Companies Code and with the Portuguese Securities Code. This act establishes cooperation, communication and publicity duties for corporations, as well as the regulation and supervision of the respective activities by the Portuguese Securities Market Commission.



# Portugal | TAX LAW

- **Corporate income tax**

## **TAXABLE ENTITIES**

The profits of companies operating in Portugal are taxable under the Corporate Income Tax Code (Código do Imposto sobre as Pessoas Colectivas – “CIRC”). The definition of “taxable profits” includes operating income and capital gains (i.e. there is no autonomous capital gains tax).

CIRC applies to companies and other corporate bodies and the applicable rules vary according to the tax residence of the taxpayer. Companies and other corporate bodies with head office or place of effective management in Portuguese territory are deemed resident in Portugal for tax purposes and subject to tax on worldwide profits. Despite the absence of statutory criteria laid down in the CIRC, in normal circumstances, a company’s place of effective management is located where the daily management of the company is carried out and the major decisions are taken (e.g. where the meetings of the company’s board of directors habitually take place).

Other resident corporate bodies that do not carry out a commercial, industrial or agricultural activity in Portugal (e.g. not-for-profit entities) are also subject to IRC although subject to different assessment rules and potentially benefitting from a total or partial exemption.

- ▶ **Non-resident entities**

*(i.e. companies and other body corporates that do not have their head office, nor place of effective management in Portuguese territory, nor have a permanent establishment therein) are only taxed on Portuguese-sourced income. The CIRC foresees that the taxable income obtained by a non-resident company which is not attributable to a permanent establishment in Portugal should be determined in accordance with the scheduler income rules set out in the Personal Income Tax Code (Código do Imposto sobre o Rendimento das Pessoas Singulares – CIRS). The taxable income obtained in Portugal by a non-resident company without a permanent establishment in Portuguese territory will be subject to a withholding tax of 25%. These rates may be reduced in accordance with the applicable Double Tax Convention (DTC), provided certain formalities are complied with.*

- ▶ **Non-resident entities with a permanent establishment in Portugal**

*A permanent establishment is defined in the CIRC as “any fixed installation or permanent representation through which an activity of commercial, industrial or agricultural nature is carried on”. In general terms, a permanent establishment is deemed to exist where a non-resident entity carries*

on its business enterprise in Portugal for a period of at least six months. Whenever a DTC applies, the Portuguese domestic concept of permanent establishment should be interpreted and applies in light of the concept foreseen in that DTC. In general terms, the taxable profits attributable to a permanent establishment are determined and subject to tax in accordance with the same rules that apply to resident companies, which means the permanent establishment is also required to prepare financial statements and have its own accounting records.

In summary, any company whose head office or place of effective management is not located in Portugal may be subject to IRC in Portugal as follows:

- Regarding profits allocated to a permanent establishment located in Portugal, IRC will be charged on the (worldwide) taxable profits attributable to it
- Regarding profits not allocated to a Portuguese permanent establishment, IRC will be charged only on income that is deemed to be sourced in Portuguese territory (in principle according to the income classification that applies for CIRS purposes)

## RATES

- Standard rate of 21%
- Municipal surtax ("derrama municipal") up to 1.5% levied on taxable profits (depending on the municipality)
- State surtax ("derrama estadual") of 3% on taxable profits exceeding € 1,5 million up to € 7,5 million, 5% on taxable profits exceeding € 7,5 million up to € 35 million and 7% on taxable profits exceeding € 35 million
- A reduced IRC rate is available for SME ("Small and Medium-Sized Enterprises"), as defined in the Decree-Law 372/2007 of 6 November. For these companies, taxable profits up to € 15,000 are subject to a reduced rate of 17%. The exceeding taxable profits are subject to the standard IRC rate
- Companies with head office or place of effective management in the Autonomous Region of Azores benefit from a reduced 16,8% IRC rate and 13,6% for taxable profits up to € 15.000 derived by SMEs
- Companies licensed under the Madeira International Business Centre (Madeira Free Trade Zone) may benefit from a reduced IRC rate of 5% until 2020, provided certain requirements are complied with (e.g. minimum number of workers in the payroll and maximum amount of taxable profits benefitting from the special IRC regime)

## • Assessment of taxable income

### GENERAL RULE

Resident companies are taxable on their worldwide income. Income and expenses should, as a general rule, be allocated to a financial period where such income and expenses are realized.

The taxable income of a resident company is based on its accounting records according to the applicable accounting rules and subject to the tax adjustments foreseen in CIRC. Portugal has adopted the International Accounting Standards effective within the European Union and according to the EU regulations on this matter. Resident companies may also carry forward tax losses up to five years. Please see section *Tax Losses*.

## **PARTICIPATION EXEMPTION**

Distribution of profits may be tax exempt pursuant to the “participation exemption” regime. According to this regime, dividends from qualified participations are not subject to tax at the shareholder company.

Under the participation exemption regime, domestic dividends are fully exempt in the hands of a non-transparent resident corporate shareholder if:

- The taxpayer, directly or indirectly, held at least 10% of the share capital or voting rights of the entity distributing the profits or reserves
- That participation was held uninterrupted, during the year prior to the distribution, or if it has been held less time, the participation must be maintained during the time necessary for the end of the period of one year
- The entity that distributes the profits or reserves is effectively subject and not exempt to IRC or a tax of the same or similar nature to the IRC and the legal rate applicable to the entity is not lower than 60% IRC rate
- The taxpayer is not subject to the tax transparency regime
- The entity that distributes profits or reserves is not an offshore

The special regime applicable to holding companies (SGPS) was revoked from 1 January 2014, and replaced by the participation exemption regime.

The participation exemption regime may also apply to dividends paid to non-residents, under some conditions.

## **EXPENSES AND NON-DEDUCTIBLE ITEMS**

Expenses related to the business activity are generally deductible for IRC purposes, insofar as they are properly documented and were incurred by the company to generate taxable profits or to safeguard its productive source.

Notwithstanding the above, certain expenses are not tax deductible, namely:

1. Interest paid pursuant to shareholder loans if the applicable rate exceeds EURIBOR 12M accrued with a spread up to 2% (except for transactions subject to transfer pricing rules where the arm's length interest rate is higher than the foregoing)
2. Expenses documented by invoices or other documents without a valid taxpayer number
3. Penalties or fines paid
4. IRC and surtaxes
5. certain expenses related with vehicles
6. Confidential or undocumented expenses, etc

## DEPRECIATION AND AMORTIZATION

All fixed assets, except land, can be depreciated or amortized for tax purposes. The acquisition or production cost of certain assets is tax deductible in accordance with their expected useful life. Depreciation can be straight-line or reducing, over a term based on the useful life of the asset. As a general rule, fixed assets are depreciated under the straight-line method, although taxpayers may elect to apply the declining-balance method. Declining-balance method cannot be applied to building properties, passenger vehicles for private use or furniture, amongst others.

The depreciation rates are established by law and deductions above such rate are not recognized for tax purposes. Taxpayers may also opt to apply longer depreciation rate (up to 50% of the general rates).

## PROVISIONS

As a general rule, provisions registered by a Portuguese company are not tax deductible, except for specific provisions foreseen in the CIRC, namely:

- Pending judicial litigations, when concerning bad and doubtful debts
- Mandatory technical provisions, constituted in accordance with the Insurance Portuguese Institute and/or Bank of Portugal rules
- Remedy of environmental damages.

## INTEREST BARRIER RULE

The Portuguese CIRC foresees an interest barrier rule which limits the deductibility of net financial expenses to the higher of:

- € 1,000,000
- 30% of EBITDA (operating profits before interests, taxes, depreciations and amortizations).

The interest barrier rule applies to all financial expenditure regardless of the existence of special relations between the debtor and creditor and the residence of the creditor. The interest barrier rule is also applicable to tax groups.

The interest barrier rule allows for the carry forward of the unused percentage (i.e. if the deduction percentage is not fully used, the gap may be added to the following five years). The excessive (non-deductible) financial expenditure may also be carried forward up to 5 years and deducted against future profits.

## **BAD DEBTS**

The costs with impairment losses derived from doubtful debts are tax deductible when an insolvency or recovery procedure has been submitted or when credits have been judicially claimed. Only impairment losses derived from debts outstanding for more than six months are qualified as tax deductible within the following limits on the amount in debt:

- From 6 to 12 months: 25%
- From 12 to 18 months: 50%
- From 18 to 24 months: 75%
- More than 24 months: 100%

## **AUTONOMOUS TAXATION**

In addition to the general CIT rate, autonomous taxation is applied on certain expenses of IRC taxpayers. As way of example, the following expenses are subject to autonomous taxation:

- Expenses related with vehicles
- Representation expenses
- Undocumented expenses
- Payments made to entities resident in blacklisted jurisdiction
- Costs or expenses with bonus and other variable remunerations paid to managers and board members

## TAX LOSSES

Losses are deductible in computing the tax base of IRC taxpayers. Tax losses generated as of tax year 2017 may be carried forward for a period of 5 years, and deducted up to to 70% of the future (annual) taxable profits. Tax losses incurred by corporate taxpayers between 1 January 2014 and 31 December 2016 may be carried forward to be set off against taxable profits for the next 12 years. The carry-forward period for losses generated in 2012 and 2013 was 5 years, and 4 years for losses generated in 2010 and 2011.

The right to carry losses forward is forfeited in case of change of ownership and control, i.e. if at least 50% of the share capital or the majority of the voting rights has been transferred. In case the losses are forfeited, a request may be submitted to the Minister of Finance who may authorize the carry-forward of the taxable losses, even if there is a change of ownership and control, provided there are valid economic reasons for such carry-forward.

## DIVIDENDS AND CAPITAL GAINS

Resident companies are subject to corporate income tax on their worldwide income and capital gains. Domestic and foreign-source dividends derived by a resident company are exempt if the following conditions are met:

- 10% minimum shareholding on the company distributing the dividends
- One year holding period (may be satisfied after the income is derived)
- The company distributing the dividends is subject and not exempt to IRC or to a tax comparable to the Portuguese IRC at a rate not lower than 60% of the Portuguese IRC rate (12.5%)

As a general rule, capital gains derived by Portuguese resident corporate entities are included in the taxable profits and subject to the general CIT rate. Likewise, capital losses may be deducted to the taxable profits.

Capital gains derived by a resident company on the sale of shares are exempt if the above-mentioned conditions for dividends are met. The capital gains exemption does not apply if the underlying company (which is being sold) is a real estate company, i.e. if the balance sheet is comprised in more than 50% of Portuguese real estate.

Capital gains derived by non-resident corporate entities are subject to IRC at a rate of 25%. Capital gains derived from the disposal of shares or other corporate rights and securities may benefit from a domestic tax exemption provided such gains are derived by a non-resident without a permanent establishment in Portugal, if the following requirements are met:

- The seller is not owned, directly or indirectly in more than 25% by a Portuguese resident company/individual or the seller is not a resident in a blacklisted jurisdiction
- The gains derived do not relate to shares or corporate rights in resident companies whose assets consist in more than 50% of real estate located in Portugal or holding companies, whenever such companies are in a control relationship with resident companies whose assets consist in more than 50% of Portuguese-situs immovable property

## GROUP TAXATION

Resident companies may elect to be taxed within a tax group of companies. The Portuguese tax group does not work as a pure consolidation or fiscal unity system, but each entity must individually assess their taxable profits / losses.

In order for a group of companies to be qualified as a tax group for Portuguese taxation purposes, the following requirements should be met: (i) the head of the tax group must be the direct or indirect holder of at least 75% of the subsidiaries' share capital, provided such shareholding represents more than 50% of the voting rights, (ii) the share capital of head of the group cannot be held in 75% or more by another Portuguese entity, (iii) all companies within the tax group must have their head office or place of effective management in Portugal and be taxed at the higher IRC rate and (iv) the participation in the subsidiaries must be held for a minimum period of one year from the moment the tax group is created.

Under certain conditions, tax losses assessed by the individual companies prior to integration may be offset against the taxable profits of the tax group.

As of 1 January 2015, it is possible to apply the group taxation regime if the dominant company has its registered head office or place of effective management in an EU or EEA country (in the latter case, provided there is administrative cooperation on tax matters similar to the one in place with the European Union). In addition, among others, the following requirements must be met:

- The dominant company owns the dominated companies for more than one year with reference to the date at which the regime starts to apply
- The dominant company is not directly or indirectly 75% held by a Portuguese dominant company
- The dominant company is subject and not exempt from a tax as per Article 2 of Council Directive 2011/96
- The dominant company is incorporated as a limited liability company

## WITHHOLDING TAXES

Domestic-source income derived by non-residents without a permanent establishment in Portugal is generally subject to a final withholding tax levied on the gross amount.

Dividends paid by a Portuguese company to its resident or non-resident shareholders are subject to a 25% flat withholding tax rate, unless an exemption for dividends paid by Portuguese resident entities is also applicable.

To qualify for the withholding tax exemption for dividend payments, the main criteria are the following: (i) 10% minimum shareholding on the Portuguese company distributing the dividends; (ii) one year holding period (may be satisfied after the income is paid); (iii) resident of shareholder is geographically limited to shareholders resident in a EU Member State, EEA (excluding those that do not exchange tax information with Portugal) or jurisdictions with which Portugal has signed a Double Taxation Agreement with exchange of information mechanism; and (iv) the company receiving the dividends should be subject and not exempt to a tax comparable to the CIRC at a rate not below 60% of the CIRC rate (i.e. 12.6%).

In case profits are distributed to a corporate entity resident in a blacklisted jurisdiction, a 35% flat withholding tax rate will apply.

No withholding tax on interest paid to Portuguese banks or local branches of foreign banks subject to IRC in Portugal.

## TRANSFER PRICING

The Portuguese transfer pricing regime has come into force in the Portuguese tax legislation in 2002 and follows closely the OECD guidelines. Under this regime, transactions entered into between related entities should reflect the arm's length principle, i.e. for tax purposes, the controlled transactions' prices should be established as if the parties were not related, by reference to the conditions which would have been obtained between independent enterprises, in comparable transactions and comparable circumstances. For these purposes, the threshold for the determination of a special relationship is currently in 20% of shareholding. In addition, an entity can be qualified as related party when it has the power to exercise, directly or indirectly, a significant influence on the management decisions of the other.

The scope of the transfer pricing regime covers all taxpayers conducting cross-border as well as domestic controlled transactions, including transactions between permanent establishments and transactions entered into with unrelated entities resident in listed blacklisted jurisdictions.



Taxpayers that in the previous fiscal year obtained over € 3,000,000 of net sales and other operating profits are required to organize compile and keep contemporaneous transfer pricing documentation for a 10 year period.

## • Personal income tax

Personal Income is taxed according to the Personal Income Tax Code (Código de Imposto sobre o Rendimento das Pessoas Singulares – “CIRS”).

### TAXABLE PERSONS

Individuals who are residents for tax purposes are taxed on their worldwide income at progressive rates varying from 0% to 48%, for 2017. The CIRS foresees specific criteria for a person to be considered resident in Portugal. The two main criteria are the physical presence test and the habitual residence test. According to the physical presence test, a person is deemed residence if he/she spends more than 183 days in Portuguese territory within any 12 months period. According to the habitual residence test, a person is deemed resident if he/she declares a primary residence (tax domicile) in Portugal.

The CIRS also foresees the possibility for a partial residence if an individual arrives to, or leaves from, Portuguese territory within the course of a taxable year.

### ► Non-residents

*Of Portugal are taxed on their Portuguese source income, in most cases through a withholding at the source. The taxpayer that has become tax resident in Portugal for a certain year and that has not been taxed as resident in Portugal for any of the previous five years may apply for the special tax regime for non-habitual tax residents. In general terms, non-habitual residents will be taxed at a flat rate of 20% in respect of employment income (Category A) and self-employment income (Category B) arising from high-value activities of a scientific, artistic or technical nature. In addition, income derived abroad may be fully exempt in Portugal provided certain conditions are complied with. The non-habitual resident has the right to be taxed as such during a ten-year period. The application for the non-habitual resident tax regime has to be submitted no later than 31 March of the year following the year in which the taxpayer became tax resident in Portugal.*

## RATES

Rates for individual tax:

Taxable income		Rate (%)	Deductible amount (€)
From €	Up to €		
0	7091	14.5	-
7091	20261	28.5	992.74
20261	40522	37	2714.93
40522	80640	45	5956.69
80640	-	48	8735.89

- Progressive tax rate depending up to 48%
- Solidarity tax may be applicable at 2.5% or 5%, depending on the taxable income
- Additional surcharge may apply up to a maximum rate of 3.25%
- The additional surcharge is expected to be eliminated in 2018

## TAXABLE INCOME

### ► Employment income, director's fees (category A) and pensions (category H)

*IRS rates applies on the earned income of employed individuals, pensions and directors' fees*

### ► Business and professional income (category B)

*IRS taxable income includes all earned income of a professional individual, such as commissions and entrepreneurial income (including rental income upon option). Such income may be taxed either in accordance with a simplified regime or based on the taxpayer's accounts.*

### ► Investment income (category E)

*Dividends and interest (bank interest, shareholder loans, from public company bonds, bills or other paper, as well as interest on public debt) are liable to taxation at a flat rate of 28% (either by means of a withholding tax or autonomous rate). However, the taxpayer may elect to include such items in taxable income in the tax return, being taxed at marginal tax rates that vary between 14.50% and 48%, in 2017. Investment income paid by non-resident entities without a permanent establishment in Portugal, but which are domiciled in a blacklisted jurisdiction, are liable to a tax rate of 35%, either by withholding tax or by the autonomous rate.*

### ► Rental income (category F)

*Rental income is subject to a 28% flat tax rate, but the taxpayer may opt to add the rents obtained to the respective taxable income in the tax return. If the taxpayer makes such election, the income shall be taxed at the progressive tax rates, with a credit given for the tax withheld. Rental income obtained by non-residents is taxed at a flat rate of 28%.*

### ► Capital Gains income (category G)

*Capital gains will be subject to tax at a flat rate of 28%. Capital gains earned by non-residents that are not borne by a permanent establishment in Portugal are fully taxable at a flat rate of 28% (with an exception for capital gains on the disposal of shares, which are exempt in certain cases). Fifty percent of capital gains arising from the sale of real estate by tax residents in Portugal is taxed at progressive rates varying from 14.50% to 48%, in 2017.*

## • Value added tax

The following transactions are subject to VAT when traders and professionals in the course of their business carry them out:

- Transfer of assets and the provision of services performed in Portuguese territory against consideration
- Imports
- Intra-community acquisitions

Depending on the transaction, a rate of 6%, 13% or 23% will be charged on the transactions (the reduced rate is applicable, namely, to some essential goods and services, such as food, agricultural goods (if not exempt), electricity, transport of passengers, accommodation in hotel units, pharmaceutical and health products; the intermediate rate is applicable to other foodstuff, wine, and certain equipment or machinery intended for agriculture or entertainment tickets).

Certain transactions are exempt from VAT (for example, financial and insurance transactions, medical services, educational services, rental of housing). Since the trader or professional performing these activities does not charge VAT on them, they do not give the right to deduct input VAT. However, there are other exempt transactions that confer the right to deduct input VAT.

## • Real state tax

### **MUNICIPAL PROPERTY TAX (IMI)**

Local authorities levy property tax on private urban and rural real estate located in the portuguese territory, at rates which vary from the type of the property, its localization, state of conservation and facilities, and are applied to a deemed value estimated by the tax authorities. The Municipal Property Tax Code has foreseen some exemptions. Applicable rates are the following:

- Rural properties: 0,8%
- Urban properties: 0,3% to 0,5%
- Properties held by entities resident in blacklisted jurisdictions: 7,5%

## ADDITIONAL IMI (AIMI)

The AIMI is new real estate tax, applicable since 2017. The AIMI must be paid by individuals or companies, as well as by structures or centers of collective interests without legal personality and undivided inheritances, that are the owner or that hold the right of “usufruct” or “superficie” of urban buildings for housing and construction lands, located in the Portuguese territory. The taxable amount corresponds to the sum of the VPT of the properties held by each taxpayer, reported on January 1 of each year.

Excluded from the taxable amount are the VPTs of immovable properties that have been exempted or have not been subject to IMI in the previous year. In the case of individuals and undivided inheritances, are foreseen a deduction of € 600,000 from the taxable amount. Married or unmarried taxpayers who chose for joint taxation under AIMI are entitled to a deduction of € 1.2 million. In that case the AIMI rate is 0.7% of the taxable amount after deductions (€ 600,000 or € 1.2 million). For taxable amounts that exceed € 1 million (or double, if it is chosen a joint taxation under this tax), the marginal rate is 1%.

In what concerns to companies, structures or collective interests centers without legal personality, the AIMI rate is 0.4% of the taxable amount. However, if shareholders, directors or any other members of corporate bodies or any of the administrative, management or supervisory bodies used the buildings, a rate of 0.7% shall be applied. For taxable amounts that exceed € 1 million, the marginal rate is 1%.

For buildings owned by entities subject to a more favorable tax regime (offshore), the applicable AIMI rate is 7.5%.

## MUNICIPAL PROPERTY TRANSFERS TAX (IMT)

IMT is levied on the transfer for consideration of real estate located in the Portuguese territory. IMT is due by the purchaser and levied on the purchase price or on the property tax value whichever is higher. The Municipal Property Transfers Tax Code has foreseen some exemptions.

## STAMP DUTY TAX

Stamp Duties Tax is charged on certain acts, contracts, documents, titles, books, papers and other facts foreseen in the General Stamp Tax Table, which occur in Portugal and are not subject or exempt from VAT or, although they occur outside the Portuguese territory, they are presented for legal purposes in Portugal. The General Table of Stamp Taxes provides for different rates depending on the type, nature, extent and purpose of the transaction. The applicable tax rates are foreseen in the General Stamp Tax Table at the time the tax is due.

# Portugal | FOREIGN INVESTMENT

Foreign investment occurs when an individual, a company or a group of entities from one country apply capital in a foreign country, which means, in an outside economy of the investor.

With the process of globalization, accompanied by the free flow of capital, the lifting of customs and tax restrictions, the movement of people and goods, this form of cross-border investment began to live a period of expansion, so that the national economies have started to receive finance from other countries.

Foreign investment can be split into direct and indirect investments. Foreign direct investments, generally known by its acronym FDI, refers to the physical investments and purchases in buildings, factories, machines and other equipment in the foreign country. The investment is direct because the investor can control, manage or have significant influence over the foreign company. Foreign indirect investments occur when companies, financial institutions or private investors purchase positions or stakes in foreign companies or also debt instruments such as bonds. Generally, this form of foreign investment is less favorable because the investor doesn't have close contact with his investment.

- **Foreign investment in portugal**

The first instrument that regulated the private investment was launched in the 1980's and proposed many bureaucratic and limiting mechanisms, since most projects (such as agriculture, agroindustry, forests, forestry, etc.) imposed a majority of public capital, and because of that all activities were reserved to the State.

In the last years, there have been profound changes due to the recognition of the advantages of an economy based on the promotion and stimulation of the private investment.

As a result of these changes of paradigm, the private investment has grown up and opened their doors to foreign investment and today Portugal is undoubtedly one of the best countries to invest.

## • Reasons to invest in Portugal

The Portuguese economy presents several elements that make Portugal an increasingly attractive and competitive country:

- **Geographical location:** as an investment destination, a factor that stands out is the geostrategic position on the Atlantic zone. Portugal is the gateway to the world markets as it is the closest European country to the United States, South America and Africa
- **Free market:** Portugal is a Member State of the European Union, which means a single currency, single market, free trade, without internal borders or other regulatory obstacles to the free movement of goods and services.
- **Competitive costs:** the operating costs in Portugal are significantly lower compared to the Western European countries and without compromising the quality. Portugal has a skilled and flexible workforce at a more favorable cost than most Western economies. There is a large variety of property to choose from with rental and purchase prices much lower than the rest of the European capitals and with the lowest level of taxes.
- **A good legal framework for investment:** Portugal has been creating a favorable legal framework for foreign investors since the legislation has adapted to the rules of a liberal foreign investment system. Government policies have prioritized the promotion of Portugal's appeal to foreign investors, introducing measures like the non-discrimination between domestic and foreign investors (when establishing a business) and the implementation of incentives for investors (contributions for the development of the business, tax benefits, etc.). It has also created a public authority (Portuguese Investment and Promotion Agency - AICEP) focused in the development and execution of structuring policies and supporting the internationalization of the Portuguese economy.

Furthermore, it is now much easier to do business in Portugal. Not only because it is possible to set up a company in less than one hour (through the mechanism "Empresa na Hora" - On the Spot Firm), but also because the taxation procedures are more simplified and it has been promoted measures to ease some labor regulations and to increase workplace flexibility.

- **Modern infrastructure:** the quality of the highway network and the air transport, which offers frequent direct flights to major business centers around the world, are important factors to the growth of investment. Lisbon is less than an hour away from Madrid with several flights every day and about two and an half hours from Paris and London. Portugal also maintains privileged ties to its former African colonies, especially Angola.

One of the many indicators of Portugal's development in this sector is precisely the fact that the Government has announced its intention to redevelop the military airbase at Montijo so that it can be used as a second airport for Lisbon, in order to cope with the ever-growing number of visitors that use Lisbon's main airport at Portela, which is expected to reach its maximum capacity sometime soon.

Finally, the port infrastructure, especially in the Sines terminal, and the railway network that provides connections from the north to the south of the country and international connections between Portugal-Spain-France and in the future until Germany, are also important factors to attract investors into Portugal.

- **Modern technological services:** we are technologically equipped for the global economy. Portugal stands out in different services such as bank services, telecommunications and renewable energy, which have been greatly improved. In fact, our Internet has the highest speed broadband and the fiber optic network was recently recognized as the best. Besides that, we are a leading country in executing operations through the ATM network and very opened to technological innovations and investments in renewable energy.
- **Talent and integration in Europe:** Portuguese people invest heavily in their education and our society is extremely internationalized. The Portuguese culture stands out for having highly educated human resources (with a higher education degree and a vocation for technology). Likewise the majority of Portuguese people speak English – the language of business worldwide – and many are capable of mastering other languages or are even multilingual. Portugal is also very well positioned in the rankings of scientific studies with thousands of publications.
- **Tourism Growth:** another important indicator is the fact that tourism in Portugal has been growing increasingly and, at the same time, the real estate market has been expanding in the same direction.
- **The high quality of life:** lately, Portugal is a good country to invest, but also to live and visit, offering an affordable cost of living and an exceptional quality of life. It is a safe country with a relatively low crime rate and a socio-political stability, since freedom, human rights and a stable democracy represent are basic values of our democratic political system. Last but not the least, the pleasant Mediterranean climate with a major of sunny days in each year makes Portugal one of the best places to live in Europe.

In addition, as a law firm, our lawyers possess specialized knowledge in international corporate operations (particularly mergers, acquisitions and joint ventures) and have the necessary experience to advise clients, prepare, conduct and conclude this kind of operations.

## • Foreign investment in portugal

In Portugal the form of foreign investment that is more common and has been growing is the Foreign Direct Investment. FDI is defined by the OECD (Organization for Economic Co-operation and Development) as a type of international investment made by an entity (direct investor) with the purpose of establishing a lasting interest on a company resident in a different country of the one the investor is registered (direct investment company). To be more specific, a non-resident individual or a company who invests at least 10% in a Portuguese company's capital and participates in the decision making of that company is a direct investor.w

In compliance with the FDI Regulatory Restrictiveness Index made by OECD, Portugal had the second less restrictive foreign investment regime in 2014. This means that the Portuguese policy in this regard is one of the most open to direct investors of all the 62 countries covered by this Index.

Over the last years, according to AICEP (Portuguese Investment and Promotion Agency), FDI has been growing substantially, which means that the investors have been reacting well to the efforts described above. In 2017, according to a study conducted by Ernst & Young, Portugal was able to capture the biggest value of FDI of the last 20 years.

According to data from the Banco de Portugal and the Directional Principle, the flow of Foreign Direct Investment into Portugal (FDI) registered an amount close to 5.5 billion Euros in 2016 (-12.3% in relation to 2015). The highest value in the last five years was registered in 2012, when FDI reached 6.9 billion Euros and in 2015 with 6.3 billion Euros.

Portuguese Foreign Direct Investment (PFDI) was close to 1.4 billion Euros in 2016 (-72.1% in comparison to the previous year). The highest value during the period 2012-2016 was in 2015 (nearly 5.1 billion Euros).

In terms of stock of Foreign Direct Investment (FDI) into Portugal, at the end of December 2016, 112.1 billion Euros (+4.4% in relation to the value in December 2015) were registered.

However, in relation to stock of Portuguese Foreign Direct Investment (PFDI) this represented close to 53 billion Euros in December 2016 (+1.7% in relation to December 2015).

In global terms the European Union was the principle origin of FDI in Portugal, with a quota of 87.5% at the end of 2016, highlighting, on an intra-Community level, the Netherlands and Spain (with 25.6% and 22.9% of the total, respectively), Luxembourg (18%), United Kingdom and France (7.6% and 4.8% respectively). Within the non-EU countries (12.5% of the total), the following are worth a mention: Brazil (2.5% of the total), the USA (1.7%), Switzerland and China (with quotas of 1.6% each), and Angola (1.2%).

The European Union was also the main destination of PFDI in global terms, with a contribution of 74.3% at the end of 2016, highlighting, on an intra-Community level, the Netherlands and Spain (with quotas of 34.1% and 22.4% of the total, respectively), followed by Luxembourg (4.1%). Within the non-EU countries (25.7% of the total in 2016), the following are worth a mention: Angola, Brazil, USA and Mozambique (with quotas of 7%, 5.2%, 2.1% and 1.7% respectively).



In essence, Portugal has an appealing economy and an open attitude towards FDI, which means that it is quite attractive to invest in Portuguese companies in a vast number of business areas and, moreover, it is highly encouraged by the Portuguese government.

- **Who may invest?**

In Portugal there are no restrictions on the entry of foreign capital. The principle guiding the Portuguese normative framework is the non-discrimination of investment on grounds of nationality. Which means there are no constraints to foreigners to invest and all the incentives are the same to domestic or foreign investors.

In fact, it is not mandatory to have a national partner nor there are limitations to the distribution of profits or dividends abroad. In essence, you can invest in Portugal as an individual or as a company and foreign companies are subject to the same rules as domestic companies. Anyhow, you will have the same conditions that are given to the nationals: the same rights and the same obligations.

- **How to invest?**

There are many possible ways to invest in Portugal, the most usual ones are the following: buying companies' capital; buying real estate; and set up a company. For all of these types of investment it is advisable to seek legal advice.

It is possible to buy stocks or bonds of the better-rated companies on the stock market (that may or may not be included on the Benchmark Index PSI 20) or to buy shares of the PME (Small and Medium-sized Enterprises). To a short-term investment, there are many companies in Portugal that are low-rated on the market and will certainly gain value. On the other hand, to a long-term investment, there are numerous companies in Portugal that distribute among the shareholder's considerable dividends.

## • Incentives offered by the portuguese government

There are loads of incentives that the Portuguese government provides to investors. Notwithstanding, these incentives are based on certain factors such as the contribution of the investment for development purpose, the size of the investment and job creation.

There are **different types of incentives**, but the most usual ones are the following four: **productive investment, research and development (R&D) investment, job creation** and **non-habitual residents**.

Within **the productive investment** there are financial and tax incentives. The financial incentives apply to new products or services or to new production methods or processes, but the innovation must be at least nationwide. It can be used in three sorts of expenses, the tangible fixed assets, such as machines, equipment and buildings; the intangible fixed assets as software and technology transfer; and the training expenses. There are two types of support, the loan up to 30% of eligible expenses with an interest-free loan and with 8-years reimbursement period or the cash grant, consisting in a loan conversion up to 60% of the incentive depending on the performance of the project.

The **tax incentives** apply to projects with positive impact on innovation and jobs creation. It includes tangible fixed assets, such as machine, equipment and buildings; and intangible fixed assets, such as software and technology transfer. There are three different types of support, the corporate income tax credit from 10% up to 25% of eligible investment; the tax benefits up to a 10-year period after the conclusion of the investment; and the exemption from Municipal Property Tax, Municipal Tax and Stamp Tax Transactions.

Nevertheless, **financial incentives** combined with tax incentives applied to the same expenses cannot exceed 25% of the eligible investment. And if the project is located in Lisbon or Algarve region, only investments in new activity are eligible up to a limit of 10% of the eligible investment.

Within the **research and development (R&D) investment** there are also financial and tax incentives. The financial and tax incentives aim to appeal to the investment in R&D activities in order to develop new products or services. It covers costs with technical staff dedicated to R&D activities; acquisition of services from third parties, including technical and scientific assistance and consulting; purchase of scientific and technical instruments and equipment (depreciations during project); and also costs associated with patents registration and acquisition.

Concerning **financial incentives** there are several types of support, such as a base rate of 25% of eligible expenses; bonuses up to 60% according to the project scope and the company size; cash grant up to € 1.000.000,00 of incentive; and for incentive amount that exceeds €1.000.000, 25% as an interest-free loan and 75% as cash grant.

In regards to **tax incentives** there are two sorts of support, which are corporate income tax credit with a base rate of 32.5% and incremental rate of 50% of the increase in expenses incurred during that period compared to the average from the previous two fiscal years, up to €1.500.000,00.

Nonetheless, financial grants combined with tax incentives, applied to the same expenses cannot exceed 80% of gross grant equivalent for industrial research projects and 60% of gross grant equivalent for experimental projects.

In terms of **job creation**, the Portuguese government, through the Public Employment Service (IEFP), supports financially and during nine months the internships for unemployed people between 18 and 30 years with at least the high school graduation and for unemployed people over 30 and under 45, if registered for at least 12 months at an employment center.

Moreover, the Portuguese government, throughout the Social Security, also exempts the company of paying social contributions if the contract is permanent. It applies to young people under 30 years looking for their first job or to long-term unemployed, registered at an employment center for more than 12 months. It allows 50% exemption from payment of social security contributions, during 5 years for young people looking for their first job and during 3 years for long-term unemployed.

There is a third option, the “Contrato Emprego” Programme, in which the Public Employment Service (IEFP) is the competent service to submit the request. This one refers to unemployed people registered at an employment center for 6 months or unemployed people under 29 or over 45, if registered for at least 2 months at an employment center. It is granted once and the amount is € 3.791,88 if it is a permanent contract or € 1.263,96 if it is a fixed-term contract (with a minimum of 12 months). However, the investor needs to bear in mind that this measure cannot be cumulatively applied with the exemption of social contributions.

At last, the **non-habitual tax resident regime** allows qualified expatriates and qualified foreign people in high added-value activities, scientific, artistic or technical activities and upper management positions, that became tax resident in Portugal, to benefit from a flat rate for income tax of 20% during 10 years, instead of pro-

gressive tax rates that can reach 48%. In addition, in general, non-Portuguese source income may be exempt under some specific conditions (eg, pensions, dividends and interest that may be taxable on the source State).

## • **Bilateral agreements to promote investments**

There are many bilateral agreements between Portugal and countries all over the world that contain binding measures in order to provide reciprocal protection and promote investments. These agreements cover four major areas, which are the entry of investments, the treatment of investments, the expropriation and losses on investments and the conflict resolution.

As so, bilateral agreements are very useful because they provide the creation of more favorable conditions to the investors of one signatory state in the territory of another, the assurance of more favorable treatment of investors and a guarantee of complete security and protection of investments already made, on a reciprocal basis.

## • **Set up a company**

It is very easy to create a company in Portugal in few hours or even in minutes. Indeed, throughout the “Empresa na Hora” (On the Spot Firm) it is possible to create a company in just one office (one-stop office) in a single day (in medium 36 minutes). The investors will no longer have to obtain in advance a certificate of company admissibility from the National Registry of Companies (RNPC). Nor will it be necessary any longer to sign a public deed.

During the incorporation procedure, the definitive legal person identification card will be handed over, the Social Security number will be given, and the company will immediately receive its memorandum and articles of association and an extract of the entry in the Commercial Register.

In other words, Portugal has become one of the cheapest (costing about 360 euros) countries in Europe to set up a company, apart from being fast and less bureaucratic than many other countries.

Also, the Legislative and Administrative Simplification Program (“Simplex”) simplified the procedures and reduced the bureaucracy associated with the creation of a company. The mandatory steps to do so are as follows: i) choose the company’s name; ii) choose pre-approved standard articles of association (customized articles of association will delay the procedure and push up the costs); iii) attend to the competent service; iv) execute the articles of association and commercial registry; v) deposit the share capital; vi) fill out the commencement of activity.

- **Golden residence permit program**

The Golden Residence Permit Program entered into force in 2012 and it is another effort to attract investors to Portugal. It applies to non European Union member-state nationals who need a residence permit and want to invest in Portugal.

This Program allows foreigners of third countries to live in Portugal and travel through the Schengen Space as long as they comply with the investment requirements established by the law.

There are many ways to acquire a golden residence permit: by transferring at least 1.000.000,00 Euro to a Portuguese bank; by buying a house in Portugal of at least 500.000,00 Euro; by spending at least 350.000,00 Euro buying and renovating a house in Portugal; or by establishing a company in Portugal and employing at least 10 people.

After making one of the above mentioned investments your lawyer can help you applying for the residence permit at the Immigration and Borders Service (SEF), for which it is required to present the following documents: passport (with proof of legal entry into national territory), criminal record, evidence of compliance with tax and Social Security obligations and the documents that prove the investment has been made (declaration of investment, declaration of the bank assuring that an international transfer of capitals has been made, etc.). It is also necessary to schedule an appointment on SEF to collect the biometric data (photography, fingerprints and signature).

It is also possible to obtain a residence permit for your immediate family members, under the family regrouping option (namely wife, sons underage, sons of age in economic dependency, parents or parents-in-law with more than 65 years or in economic dependency) by submitting their documents, which will be the same as the above, plus a proof of family bond (for example, the certificate of marriage or

the certificate of birth) and minus the investment documents.

After obtaining the residence permit it is mandatory to maintain the investment for a minimum of 5 years. After the first and the third years the residence permit needs to be renewed. For the renewals the procedure is the same as for the submission, the only difference is that it is required a proof of the stay in Portugal for at least 7 days (continuously or intermittently) during the first year and 14 days (continuously or intermittently) during the following two-year periods.

After 5 years since the date of submission it is possible to apply for a permanent residence permit. On this final stage you will need to present your criminal record, proof of means of subsistence, proof of accommodation and, lastly, you will need to prove a basic knowledge of the Portuguese language. Alternatively, 6 years after the date of submission, it is possible to apply for Portuguese citizenship.

Lastly, the Golden Residence Permit is subject to three administrative fees: the application costs € 517,40 for the investor and € 80,60 for each family member; if the application is accepted, the issue of the golden residence permit costs € 5.173,00 for each one (the investor and his family); and, finally, each renewal costs € 2.568,75 for each one (the investor and his family).

## • Real estate sector

The real estate sector with its luxury properties in the center of the cities, like Lisbon and Oporto, at competitive prices is the main attraction of investors from different parts of the world, such as France, Brazil and China.

Since the entrance in the Eurozone in 1999 foreigners investors have been investing in Portugal approximately € 4.2 billion of foreign capital in the acquisition of 150 real estate assets. The majority is from Germany, the United Kingdom, Netherlands and the United States of America.

The end of the exchange rate risk and the positive evolution of the retail and office sectors contributed to attract foreign investment, which sought to take advantage of the expected capital appreciation.

Attractive prices, the potential for good return through subsequent lease, tax benefits and programs such as Residence Permit for Investment Activity (ARI), allied with hospitality and security have led to a growth of investment in this sector. Furthermore, the Portuguese government has recognized the importance of the real estate sector to attract Foreign Direct Investment and, in this sense, has joined efforts to establish measures to facilitate and attract private investment (like real estate restructuring)

The investment in rural property has also developed due to the increasing of the rural tourism. Portugal is, undoubtedly, a country that offers a unique climate and has an extension of nature that stands out from many countries and in the face of those potentialities the Portuguese government has also sought to establish measures to support this growing form of tourism and investment.

In fact, in the last years the tourism sector has registered an exponential increase, with an enlargement of the number of tourists visiting the country. This growth has impacted Portugal's economy and in special the real estate sector in a very positive way. In particular, new tourist accommodation has been opening at a fast pace and there has been a clear growing interest shown by international hotel chains that are currently seeking new opportunities to invest in the country, with a particular focus on Lisbon, Oporto and Algarve.

Lisbon, in particular, has been the center of investment. Although the Portuguese capital may not be quite as popular as some other major European capitals, like Paris and Rome, the fact that property prices in Lisbon are far more affordable than those found in other major capitals combined with the rising of the tourism makes Lisbon the perfect place to invest.

- **Other investment opportunities**

The electric and electronic sectors have also attracted many investors and provided many opportunities. With more than 7.600 companies in ICT, the Portuguese information and communication technologies market has shown itself capable of rapid adaptation to and effective assimilation of new inventions. Biological industries also bring together several international projects in domains such as pharmacy, biotechnologies (especially with renowned Portuguese universities) and research and development.

- **Conclusion**

In conclusion, there is a large variety of forms of investment to choose in Portugal. All are very compelling and can be highly profitable. As we described above, the potentialities as a country are evident and procedures to invest are quite simple, but this does not exempt the legal advice, which is always recommended in order to make sure everything goes according to plan as well as to obtain protection against any political or legislative uncertainty that characterizes even the most sophisticated country.

# Portugal | LABOUR LAW

This chapter provides a brief overview of the main aspects of Portuguese labour law, namely about employment contracts and social security related matters.

Portuguese labour law is governed by the Labour Code, which entered into force on late 2003. On 2009, a new version of the Labour Code has been published and currently provides the regulation of the main employment-related features, such as types of employment contracts, holidays, absences to work, professional training, gender equality, maternity rights, termination of employment contract and health and safety at work.

## • Employment Contracts

Under Portuguese law, there are 3 main types of employment contracts: permanent, fixed-term and uncertain term.

Additionally, we also highlight the management employment contract, due to the wider flexibility it offers to companies when hiring top employees, because such contracts may be unilaterally terminated by the company without cause, although in such a case, the employee is entitled to compensation (see below II.4).

### COMMON PROVISIONS

The following aspects are common to every type of employment contracts:

#### ► Retribution

*Besides the base salary, employees are entitled to an annual holiday allowance and Christmas allowance, which amount is equivalent to the base salary. The minimum national wage is currently €557,00, although the applicable collective agreements, if existing, usually provide higher minimum amounts per each professional category. Employees may also be paid other allowances, depending on the terms under which the work is performed, such as the nightshift allowance or the shift allowance.*

*Generally, some of these allowances - such as the shift allowance or the meal allowance - are provided in the applicable collective bargaining agreement, as its payment is not mandatory by law. Besides, the payment of the meal subsidy is a common practice, even if not provided in any collective bargaining agreement.*



**► Working hours**

*As a general rule, employees may be committed to a maximum working schedule of 8 hours per day and 40 hours per week. The parties may also agree on a part-time working schedule.*

*The work performed beyond these limits (and also on resting days) is considered as overtime work, which, itself, is limited to a certain number of hours per day and per year. The performance of overtime work entitles the employee to a special allowance per each hour of overtime work rendered.*

*Depending on the type of functions, the employer and the employee may agree on a working hours exemption schedule, case where said daily and weekly limits shall not apply. Being the case, the employee is entitled to a monthly allowance, which amount is equivalent to, roughly, 20%/25% of the base salary, save if provided otherwise in the applicable collective agreement.*

*The Labour Code 2009 has introduced new types of scheduling the working hours in order to adapt the working schedules to the production needs, enabling the employer to concentrate a greater number of hours of work per day and per week or to manage the daily and weekly limits of hours of work in accordance with the production flows. Initially, the implementation of some of these schedules has to be previously agreed with the employee's representatives in the applicable collective bargaining agreements.*

**► Holidays and days-off**

*Employees are entitled to a paid annual holidays period of 22 working days. Companies may grant a higher holiday period. Also, the collective agreement, if existing, may provide for a higher duration of the holidays. In the year of admission, employees are entitled, after 6 months of execution of the contract, to 2 working days of holidays per each month of duration of the contract.*

*Employees are also entitled to a mandatory rest day (usually, on Sundays) and to a complementary rest day (usually, Saturdays). Additionally, there are 9 paid public holidays and 2 non-mandatory public holidays (local holiday and Mardi Gras).*

**► Maternity and paternity leave**

*This is one of the matters that has been amended by the Labour Code 2009, extending the duration of parental leaves and allowing it to be taken jointly or alternatively by the employee and the spouse. The main difference is now between parental leave taken exclusively by the employee (whether female or male) or jointly with the spouse. As a general rule, the parental leave is 150 or 180 days after the birth, where 6 weeks are mandatory for the female employee. The spouse (male employee) is always entitled to a leave of 10 working days (consecutive or not) after the birth. If the parental leave is exclusively taken by one of the spouses, its duration may vary from 120 to 150 days.*

*During the parental leave, these employees are entitled to a subsidy paid by the social security, as the salary is not due by the employer. In some cases where parental leaves are extended by decision of the employee, the subsidy paid by the Social Security may be reduced and salary will still not be due by the employer. There are also other leaves supported by the social security, for purposes of assistance to family, which duration has also been extended by the Labour Code 2009. The employer and the employee may, at any time, agree on an unpaid leave.*

### ► Sickness and injury

*Absences to work due to illness or injury are deemed as justified absences. In these cases, the salary is not due by the employer as employees are entitled to a subsidy paid by the social security.*

*In case of labour accidents, the insurance company shall be responsible for the payment of the salary and other compensation for any damages suffered by the employee as a result of the accident. To such extent, under the law, the employer has to enter into an insurance contract for labour accidents, otherwise it shall be liable for every costs and compensation due to the employee. Moreover, the non-compliance with this obligation constitutes a serious infringement, subject to a fine applied by the Labour Authorities.*

### ► Termination

*As a general rule and save in the cases of termination with cause for disciplinary reasons, the employer is absolutely prevented from unilaterally terminate the employment contract.*

*However, during the trial period, either party may unilaterally terminate the employment contract with immediate effects and no compensation is due, save if agreed otherwise. Should the employer wants to terminate the contract in the trial period and if the contract has been in force for more than 60 days, the termination has to be communicated 7 days prior notice and if it the contract is being executed for more than 120 days, said prior notice is extended to 15 days.*

*The employee may terminate the employment contract at any time by means of a prior written communication, which varies according to the type of contract (see below).*

*The employee may also terminate the employment contract with cause, if the employer has breached any legal or contractual rights, case where it shall be liable for the payment of a compensation, to be settled by the court, ranging from 15 to 45 days of base salary per each of seniority, with a minimum equivalent to 3 months of base salary.*

## TERMINATION WITH CAUSE

The termination with cause requires a previous internal written proceeding, where the employee may file a reply and require the hearing of witnesses and other means of proof. This internal proceeding is detailed in the law and should the company fail to comply with certain formalities the dismissal is deemed as wrongful. In the course of this proceeding, the workers' committee (if existing) and the trade union (if the employee is an union representative) have also to be consulted. Additionally, in the case of pregnant and breast feeding employees, the dismissal requires a favourable opinion from a governmental body committed to gender equality and maternity protection.

The law defines cause for termination as a serious and intentional conduct of the employee, which determines the immediate impossibility of maintenance of the employment relation, i.e., the breach of legal and contractual duties.

The employee may judicially dispute the dismissal within the year subsequent to the dismissal. The burden of proof of the existence of cause for termination relies on the employer.

Should the dismissal be ruled wrongful, the employee may opt to be reinstated in the company or to be paid a compensation, to be settled by the court, ranging from 15 to 45 days of base salary per each of seniority, with a minimum equivalent to 3 months of base salary. In the case of small companies (less than 10 employees) or management employees, the company may oppose to the reinstatement, case where the compensation shall vary from 30 to 60 days of base salary per each year of seniority.

Additionally, the company has also to pay to the employee a compensation for any moral or patrimonial damages resultant from the dismissal and also the unpaid salaries due since the date of the dismissal until the date of the court's ruling. In the case of term employment contracts, the amount of this compensation cannot be lesser than the unpaid salaries due since the date of the dismissal until the term of the contract (or until the date of the court's ruling, should it occur before the term of the contract).

#### **INDIVIDUAL REDUNDANCY AND COLLECTIVE DISMISSAL**

Besides termination with cause, the employer may only terminate the employment contract grounded on objective reasons, specifically market, financial or technological reasons. The burden of proof of the existence of these grounds for termination relies on the employer.

If, within a 3 months period, the employer intends to terminate, at least, 2 or 5 employees (whether the company has up to 50 employees or more than 50 employees, respectively) the collective dismissal shall apply, otherwise the individual redundancy procedure shall be the applicable one.

In order to terminate the employment contract, either by redundancy or in the extent of a collective dismissal, the employer has to enact a procedure, which involves the affected employee(s), the workers committee and the Ministry of Labour.

In short, the procedure comprises 3 stages: (i) initial written communication to the affected employee(s), (ii) information and consultation with the employees and

their representatives and (iii) decision of the procedure, which has to be communicated with prior notice, from 15 to 75 days, depending on the seniority of the affected employee(s).

The compliance with the several legal requirements foreseen for the initial communication and for the decision is most relevant, otherwise the termination shall be deemed as wrongful.

The termination by redundancy or by collective dismissal entitles the employee to a compensation. The compensation will be calculated in different terms, whether the employment contract has been entered into before or after November 1 2011.

For contracts prior to November 1 2011, compensation shall be calculated in the following terms: (i) in respect to the period of execution of the contract until October 31 2012, compensation is equivalent to one month of base salary per each year of seniority; (ii) in respect to the period from November 1 2012 to September 30 2013, the compensation is equivalent to 20 days of base salary per each year of seniority and (iii) in respect to the period from October 1 2013 until the date of termination, the compensation is equivalent to 18 days of base salary per each complete year of seniority (in the first 3 years, when the contract has not reached 3 years on October 1 2013) and to 12 days of base salary per each complete year of seniority (in the subsequent years until the date of termination). The compensation calculated in accordance has the following with these rules cannot be lesser than the equivalent to 3 months of base salary. In respect to the periods referred in (ii) and (iii) the relevant salary cannot exceed 20 times the minimum national wage (€11.140,00) with a maximum amount equivalent to 12 times the monthly base salary (or, if the monthly salary exceeds €11.140,00, the compensation cannot exceed €133.680,00 (240 times Portuguese minimum wage).

For contracts entered into between November 1 2011 and September 30 2013, the compensation shall be calculated in the terms referred in (ii) and (iii), with the maximum limits referred above. However, these rules have the following exceptions:

- When the first parcel of the compensation (i.e., from the admission to October 31 2012 or from the admission to September 30 2013, as the case may be) is equivalent or exceeds 12 times the monthly salary of the employee or 240 times the Portuguese minimum wage (i.e., €133.680,00), the remaining parcels of the compensation shall not be calculated, thus, the compensation shall be exclusively calculated until said dates.

- If the part of the compensation calculated until the dates referred in (a) above does not exceed 12 times the monthly salary of the employee or 240 times the Portuguese minimum wage (i.e., €133.680,00), the total amount of the compensation cannot exceed these limits.
- If the parts of the compensation for contracts prior to November 1 2011 referred in (i) and (ii) above is equivalent or exceeds 12 times the monthly salary of the employee or 240 times the Portuguese minimum wage (i.e., €133.680,00), the parcel (iii) shall not apply. If the same parts of the compensation referred in (i) and (ii) does not exceed 12 times the monthly salary of the employee or 240 times the Portuguese minimum wage (i.e., €133.680,00), the total amount of the compensation cannot exceed these limits.

For contracts entered into after October 1 2013 compensation is equivalent to 12 days of base salary per each complete year of seniority. If the court rules the termination as wrongful, the terms referred above in respect to termination with cause shall apply.

#### **TERMINATION BY AGREEMENT**

The employer and the employee may, at any time, agree in written on the termination of the employment contract. The law does not provide any minimum or maximum limits for the compensation to be paid (in fact, the payment of a compensation is not mandatory).

The employee may revoke the termination agreement within the 7 days subsequent to the date of its signature, save if it is entered into before a public notary, where it shall produce its effects irrevocably as of the date of signature.

#### **PERMANENT EMPLOYMENT CONTRACTS**

This is the standard type of employment contracts, as term employment contracts may only be entered into under specific conditions (see below). The contract does not have to be executed in written, although under the law, the employer has to render to the employee information on the basic terms of the agreed employment.

The trial period for these contracts varies according to the functions to be performed: (i) 90 days for standard employees, (ii) 180 days for employees holding a trust position or committed to functions requiring high technical skills and (iii) 240 days for management and senior employees. However, the parties may agree on the reduction or exclusion of the trial period. Save in the cases of termination during the trial period, termination with cause, individual redundancy or collective dismissal, the employer is absolutely prevented from unilaterally terminating the employment contract.

The employee may terminate the contract at any time by means of a written communication addressed to the employer with 30 or 60 days of prior notice, whether he/she has up to 2 years or more than 2 years of seniority, respectively.

## **TERM EMPLOYMENT CONTRACTS**

This type of employment contracts may only be entered into to face a temporary need of workforce and for the period of time strictly necessary. Although the law provides an open clause to define said “temporary need of workforce”, it also foresees some situations which generally enable the employer to hire term employees, from which we highlight the following: (i) replacement of employees temporarily prevented from rendering their activity, (ii) exceptional increase of the company’s activity, (iii) execution of a determined work or project (e.g., a services agreement entered into by the company), (iv) start-up of a new company or activity and (v) hiring of first-job seekers or long term unemployed persons.

Failure to comply with these requirements determines that the contract shall be deemed as a permanent one.

There are fixed-term employment contracts and uncertain term employment contracts, where the first are the most common.

Fixed term employment contract may be entered for a maximum of 3 years and within such period be subject to 3 renewals. Uncertain term employment contract are limited to a maximum duration of 6 years.

The employee may terminate the fixed-term contract at any time, by means of a written communication addressed to the employer with 15 or 30 days prior notice, whether the contract has been entered into for less than 6 months or for 6 or more months, respectively.

The fixed term contract terminates in the end of the agreed term (or of its renewals). To such effect, the employer has to communicate the termination to the employee by means of a written communication with 15 days notice before the said term, otherwise the contract shall be automatically renewed or converted into a permanent employment contract (if it cannot be renewed again or if it has reached its maximum duration).

The employee may also terminate the contract in these terms, by means of a written communication addressed to the employer with 8 days prior notice.

The termination of the contract by the employer upon its terms entitles the employee to a compensation, in the following terms:

For contracts entered into before November 1 2011, compensation shall be calculated in the following terms: (i) in respect to the period of execution of the contract until October 31 2012, compensation is equivalent to 2 or 3 days of base salary per each month of duration of the contract, whether the contract has been in force for more than 6 months or up to 6 months, respectively one month of base salary per each year of seniority; (ii) in respect to the period from November 1 2012 until September 30 2013, compensation in equivalent to 20 days of base salary per each year of seniority and (iii) in respect to the period from October 1 2013 until the date of termination, compensation is equivalent to is equivalent to 18 days of base salary per each complete year of seniority (in the first 3 years, when the contract has not reached 3 years on October 1 2013) and to 12 days of base salary per each complete year of seniority (in the subsequent years until the date of termination).

The exceptions and limits to the amount of the compensation provided above for permanent contracts shall also apply.

The termination of a term employment contract by the employee does not entitle him/her to be paid any compensation.

The recent amendments to the provisions on the compensation have enacted a new system of payment of the compensation, **applicable only to employment contracts entered into after October 1 2013**. To ensure that the compensation is paid by the employer, two public Funds have been created (although the employer may opt by a private Fund). These Funds are funded by the employer, which has to deliver monthly an amount equivalent to 1% of the employee's salary.

When the contract terminates – except in the cases of agreement – the compensation is paid by the employer but the Fund shall support half of the amount paid.

## MANAGEMENT EMPLOYMENT CONTRACTS

These contracts are less common in Portugal but represent more flexibility to the employer as it may terminate it at any time. The Labour Code has extended the cases where this contract is admissible. Therefore, besides the cases of employees committed to managing (or equivalent) functions directly dependent from the board of directors, as well as to the admission of personal secretaries of employees holding such management positions, management employment contracts may now also be entered into for the so called 2nd line directors (directors dependent of the General Manager).

The main aspects of these contracts remain unaltered, as follows:

- 180 days trial period (may be reduced or suppressed by agreement of the parties)
- Either party may terminate the contract by means of a written communication addressed to the other party with 30 or 60 days of prior notice, whether the employee has up to 2 years or more than 2 years of seniority, respectively (the parties may agree on the extension of the notice period)
- Termination by the employer entitles the employee to a compensation equivalent to 20 days of base salary per each year of seniority, with a maximum amount equivalent to 12 months of base salary, or, if the monthly salary exceeds €11.140,00, the compensation cannot exceed €133.680,00 (240 times Portuguese minimum wage). In any case, the amount of the base salary for calculation of the compensation cannot exceed the equivalent to 20 times the Portuguese minimum wage (currently, €557,00, thus, the limit is €11.140,00)

## • Social Security

### CONTRIBUTIONS

The employer and the employee have to pay contributions to social security, which are calculated over the regular salaries paid to the employee, through a 34,75% rate, where 23,75% is supported by the employer and 11% is supported by the employee under a PAYE system.

In respect to members of the board committed to executive functions, since January 1 2013 the social security rate is the same, being applied over the real salary, with a minimum equivalent to the Social Benefits Index (currently, €421,32).

### UNEMPLOYMENT SUBSIDY

The termination of an employment contract shall entitle the employee to the unemployment subsidy whenever the unemployment has not resulted from a decision of the employee (save in the cases where the employees terminates the contract with cause).

The unemployment subsidy is granted by the social security services. Its amount is calculated in accordance with the salary of the beneficiary in the 14 months preceding the unemployment and shall be equivalent to 65% of that salary. The amount of the unemployment subsidy is limited to 2,5 times the Social Benefits Index (currently, €1.053,30 - €421,32 \* 2,5).



This subsidy is granted for a period which duration varies in accordance with the age and the contributions record of the employee/beneficiary, from a minimum of 150 days to a maximum of 780 days.

The beneficiary is prevented from cumulating the unemployment subsidy with other income resultant from a professional activity, save in limited cases of low income.

## **RETIREMENT**

The statutory age for retirement is currently 66 years and 4 months, and the applicant to the pension has to have a minimum of 15 years of registered and paid contributions to social security. As a general rule, the beneficiary may cumulate the retirement pension with income resultant from the performance of a professional activity.

In specific case, depending on the contributions record and on the age at the date of unemployment, an anticipated retirement may be requested by long-term unemployed persons, after the termination of the granting period of the unemployment subsidy.



# Portugal | REAL ESTATE

## • Types of Ownership

According to the Portuguese Civil Code, ownership consists in the full and exclusive right of use, enjoyment and disposal of a real estate property or personal property (commodities), including all direct advantages resulting there from (as revenues).

Portuguese law foresees other property rights such as the right to use the property (“usufruto”), the naked property (“nua propriedade”), the surface property, the timesharing, the horizontal property, and others.

The adverse possession (“usucapião”) is one method of acquiring property through actual, continuous, open occupancy of the property, for a prescribed period of time, under claim of right, and in opposition to the rights of the true owner.

## • Land Register

All transactions concerning real estate property must be duly registered with the Real Estate Registry Office (which may be submitted online). In order to impose that obligation, the law establishes that definitive registration constitutes legal presumption of the existence of the right and its ownership by the person who is inscribed in the registry records. This means that the land certificate (“título de registo da propriedade”) confers to the owner of the property the power to exclude any alien pretension over the registered right.

The onerous acquisitions of property rights made by third parties, in bona fides, from a person who appears in the registry records as entitled to transfer such right shall be held harmless against any property claims.

All registered records are public so as to allow the assessment of information concerning the ownership and/or any existing encumbrances on a real estate property.

## • Transfer formalities

According to Portuguese law, the constitution, transfer, acquisition or extinction of property regarding real estate assets may be made through a Public Deed or a Simple Document duly authenticated by a Lawyer. Additionally, other documents may

be required, as well as the execution of legal and prior formalities, including the payment of taxes, such as:

- Occupation or construction license issued by the city hall (for urban buildings)
- Land registry title, proving the ownership of the transferor
- Payment of the Real Estate Transfer Tax ("IMT") - between 0% and 8%, depending on the real estate type and its value
- Real Estate Tax Record ("calderneta predial") issued by the competent tax services
- Energetic Certificate of the Property (which certifies the class of energy efficiency of the property)
- Technical Datasheet of the Property ("Ficha Tcnica da Habitaao") – it is only mandatory for properties build after March 30th, 2004

Additionally, all real estate properties are subject to the payment of a Property Tax which ranges between 0,3% and 0,45% of the patrimonial value of the real estate (concerning rural property, the tax is 0,8%; as to property owned by entities with fiscal residence in Tax Heavens, the tax is 7,5%). In case of properties situated in Lisbon, an additional tax of 0,0375% will be added to the previous Property Tax ("Taxa Municipal de Protecção Civil").

It entered into force a new project of the so-called "Casa Pronta". This regime allows purchases, encumbrances or registrations of real estate properties to be carried out immediately and by a sole entity. Thus, the public deed, the payment of the IMT and the attaining of all necessary documents (habitation license, land registry title and real estate tax record) may be all carried out simultaneously by the same authority, significantly reducing the bureaucratic procedures of the real estate transfers in Portugal.

## • Mortgages, main rights of mortgages

A Mortgage is a lien by virtue of law (security in rem) that confers to the creditor a preferential right over the other creditors, and that can be defined, in simple terms, as an ancillary guarantee aiming at assuring the fulfillment of contractual obligations.

The law provides for three different types of mortgages: voluntary, judicial and legal. The voluntary mortgage must be constituted by means of a Public Deed or a Simple Document duly authenticated by a Lawyer (or will) and must specify the mortgaged property. All kinds of mortgages should be registered, in order to have existence and to produce effects against third parties.

- **Restrictions on acquisition**

The Portuguese law has no restrictions to what concerns the possibility of property acquisition by foreigners.

On the contrary, there are many incentives for foreign investment in Portuguese property, which are better described at *Golden Residence Permit Program*. Foreign Investment.

- **Construction and use restrictions**

The exercise of rights related to ownership is not absolute, considering that Portuguese Law determines the compliance with restrictions and boundaries imposed by the social and dynamic function of ownership.

Besides the general clause of “proibição do abuso de direito” (prohibition of abuse of right), the public expropriations and temporary requisition, we have to note on two different types of restrictions: “public law restrictions” and “private law restrictions”.

As to public restrictions, we have to consider specific legislation linked to, e.g. town planning law (inspections and supervision of construction works) that covers areas like waters, environment, air quality protection, forests, industry, work licensing, natural parks, sanitation, noise, etc.

Concerning the private law restrictions, they are foreseen in the Portuguese Civil Code, and are numerous, as for example easements, excavations, water flowage, right of demarcation, right of dividing and joining rustic buildings, etc.

- **Lease formalities**

The urban lease agreement must be made in writing and the contract must include several essential elements, such as Occupation’s license, Real Estate Tax Record issued by the tax services, and other relevant documents.

Unless the parties expressly state otherwise, the landlord can only prevent the automatic renewal of the contract by means of a notification of such intention sent to the tenant with a minimum prior notice, depending on the duration of the lease agreement. Nevertheless, either party (tenant or landlord) may terminate the contract in certain cases of breach or default by the other party.



S

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MOLL WENDÉN Business Law Excellence



# Karanović & Nikolić

—  
Serbia

## General information

Karanović & Nikolić is a leading international legal practice in South East Europe with a team composed of over 100 lawyers who cooperate together across the region. The Karanović & Nikolić team offers unrivalled regional and sector specific coverage to investors. We are market leaders because of our dedication, quality legal service, and in-depth understanding of the needs of our clients.

By cooperating with over 100 lawyers across the region, our original values remain an integral part of our philosophy and approach to client work. Lawyers practicing in cooperation with Karanović & Nikolić have been involved in many of the largest and most complex transactions in the region and we take pride in our reputation as a transactional and corporate/commercial legal powerhouse.

## Team

Because we have a business presence in Serbia and a long standing cooperation with attorneys-at-law in Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, and Slovenia and lawyers associated with Karanović & Nikolić operate seamlessly across all of these jurisdictions, providing services to our clients and taking into consideration local particularities in order to provide the best legal advice under competitive terms.

### 📍 Head Office

Resavska 23  
11 000 Belgrade, Serbia

☎ +381 11 3094 200

📠 +381 11 3094 223

[knserbia@karanovic-nikolic.com](mailto:knserbia@karanovic-nikolic.com)

[www.karanovic-nikolic.com](http://www.karanovic-nikolic.com)

### 👤 Contact person

Stefan Simić  
Business Development

☎ +381 11 3955 475

📠 stefan.simic@karanovic-nikolic.com

Corporate Law in Serbia is generally regulated by the Company Law published on the 27th of May, 2011, in the “Official Gazette of the Republic of Serbia” no. 36/2011 which came into force on the 4th of June, 2011, and by the Law on Registration Procedure with the Business Registers Agency published on the 27th of December, 2011, in the “Official Gazette of the Republic of Serbia” no. 99/2011 which came into force on the 4th of January, 2012. The Company Law was amended on the 27th of December, 2011, the 5th of August, 2014, and the 20th of January, 2015 (“Official Gazette of the Republic of Serbia” nos. 99/2011, 83/2014 and 5/2015) and the Law on Registration Procedure with the Business Registers Agency was amended on the 5th of August, 2011 (“Official Gazette of the Republic of Serbia” no. 83/2014).

The Company Law regulates the legal status of companies and entrepreneurs, their incorporation, governance, affiliation, changes of legal forms, status changes and the liquidation of companies. The Law on Registration Procedure with the Business Registers Agency regulates the conditions, subject, and the procedure of registration with the Business Registers Agency and the operating procedure of this Agency.

## • Types of companies

Business in Serbia may be conducted by incorporation of the company in one of the following legal forms:

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

Alternatively, business may be conducted either by the incorporation of a branch office (in Serbian: *ogranak*) or a representative office (in Serbian: *predstavništvo*) of the foreign company. Branch or representative offices are not considered separate legal entities and therefore the foreign company remains liable for all obligations assumed by a branch office or representative office.

General and limited partnerships are not that common in Serbia due to the unlimited liability of shareholders for the debts of the company, whereas the minimum share capital of joint stock companies is rather high and it is in the amount of approx. EUR 25,000, which makes this legal form seldom used in practice as well.

The limited liability company (in Serbian: *društvo sa ograničenom odgovornošću - d.o.o.*) is by far the most commonly used legal form in practice. This is due to the rather straightforward incorporation procedure, minimum requirements in relation to the share capital of the company (approximately EUR 1), and the fact that the shareholders are not liable for the debts of the company (except in specific circumstances, e.g., if there are grounds for the piercing of the corporate veil). A shareholder may have only one share in the company, which is expressed as a percentage.

The capital contributions by shareholders may be made in money – Serbian dinars or “in kind”, such as equipment, goods, know-how, etc. which do not have to be paid/contributed before registration, but within five years after the execution of the founding act. The value of contributions in kind can be assessed by the shareholders themselves.

The limited liability company can engage in all legally permitted activities, but its predominant business activity (taken from an exhaustive list of business activities provided by Serbian laws) must be defined in the Memorandum of Association and registered with the Business Registers Agency. There are certain activities (e.g. financial services and insurance services), that may only be performed by an entity incorporated in a certain legal form (e.g. joint stock company), and certain activities (e.g. trade in poisonous goods, medicines or weapons) that may be subject to licensing requirements.

Joint stock companies (in Serbian: *akcionarsko društvo – a.d.*) can be founded by one or more natural and/or legal persons, and the company’s share capital is divided into shares. Shareholders are not liable for the debts of the company (except in specific circumstances, e.g., if there are grounds for the piercing of the corporate veil). There are two types of joint stock companies, closed and open (public), depending on whether the shares are listed on the stock exchange market or not. Currently, most of the joint stock companies in Serbia are banks and insurance companies, as this is the statutory requirement of the specialised laws. As mentioned, the minimum amount of the initial share capital of the joint stock companies is significantly higher than the one prescribed for limited liability companies, and it amounts to approx. EUR 25,000.

Joint stock companies can issue ordinary and preference shares. Ordinary shares have the same nominal value or have no nominal value at all, in which case their accounting value is used as grounds for determining the amount of dividends or liquidation proceeds belonging to their holders. Preference shares include, in particular, priority rights in the payment of dividends, and priority in payments of the liquidation proceeds. However, holders of preference shares do not have voting rights except in a limited number of cases explicitly stated in the law. The company’s Articles of Association can prescribe that the company can approve shares

that are not issued. These shares can be issued for the purposes of increasing the share capital of the company by making new contributions.

## • Corporate Governance: Classes

### LIMITED LIABILITY COMPANIES

Corporate governance in a limited liability company can be organised as a one-tier or two-tier system. In the one-tier system, besides the Shareholders Assembly, a company has one or more directors (not forming any separate corporate body, such as a Board of Directors), all of whom are presumed to act as executives, in charge of the day to day running of the business of the company.

In the two-tier system, besides the Shareholders Assembly, there is (i) a Supervisory Board which acts as a separate supervisory and controlling body; and (ii) one or more directors (executives). The Supervisory Board consists of at least three members, appointed by the Shareholders Assembly, none of whom can serve as (executive) directors. The Supervisory Board in turn appoints and controls the work of director(s) who are in charge of running the daily business of the company and are considered as executives.

The Shareholders Assembly operates through sessions which can be held in person or via a conference call. In case of a sole shareholder, the functions of the Shareholders Assembly are performed by the shareholder itself. If not otherwise provided by the Company Law or the company's Memorandum of Association, the Shareholders Assembly:

- Adopts amendments to the Memorandum of Association
- Supervises the work of directors, determines the compensation of directors i.e. guidelines for the determination of such compensation
- Appoints the auditor and determines the compensation for his engagement
- Appoints and dismisses the directors of the company, and adopts reports of the directors of the company
- Adopts the financial statements, and auditor's statements if the financial statements were audited
- Decides on increases and decreases to the company's share capital and on any emission of securities
- Decides on the initiation of the liquidation procedure, as well as on the submission of a proposal for the initiation of company bankruptcy proceedings;
- Decides on the distribution of profit and the manner of covering losses, including the determination of the day of acquiring the right to participate in profit and the day of the payment of dividends to the shareholders of the company
- Appoints the liquidation administrator and adopts the liquidation balance sheets and the reports of the liquidation administrator

- Decides on the acquisition of treasury shares
- Decides on the exclusion of a company shareholder due to a non-payment, i.e. failure to pay in the subscribed share
- Decides on status changes and changes of legal form
- Decides on additional payments to the shareholder of the company and on the return of such payments
- Decides on the initiation of the proceedings for the exclusion of a company shareholder
- Approves the legal transactions involving personal interest
- Decides on the shareholder's request for the withdrawal from the company
- Decides on withdrawing and cancelling the shares
- Approves acquiring, selling, leasing, pledging or otherwise disposing of the assets of significant value

The annual Shareholders Assembly has to be held within six months from the end of the business year.

All the decisions of the Shareholders Assembly are enacted by a simple majority of votes, but only if shareholders that have majority of the total number of votes are present at the session on which these decisions are enacted. However, certain decisions of the Shareholders Assembly require a higher majority, unless the Memorandum of Association provides that these issues will be decided by another majority which may not be less than the majority of the total number of votes.

### JOINT STOCK COMPANIES

The corporate governance of joint stock companies can also be organised as a one-tier system or a two tier system.

In the one-tier system, besides the Shareholders Assembly, a company has one or more directors who form a Board of Directors in case there are three or more directors. They may be executive directors and non-executive directors. If there are less than three directors, all of them are considered executive directors, in charge of the day to day running of the company business. Non-executive directors oversee the work of executive directors, propose a company business strategy and oversee its implementation.

In the two-tier system, besides the Shareholders Assembly, there is (i) a Supervisory Board which acts as a separate supervisory and controlling body; and (ii) one or more executive directors who form an Executive Board in case there are three or more executive directors. The Supervisory Board may name one of executive directors as the director general in case there is no Executive Board, while in cases where there is an Executive Board, it has to name a director general. The role of a director general is to coordinate activities of the executive directors and to manage the business of the company.

The authorities of the Shareholders Assembly are very similar to the authorities of this body in limited liability companies. The regular session of the Shareholders Assembly has to be held once a year within six months from the end of the business year. Decisions of the Shareholders Assembly are enacted by a simple majority of votes, but only if shareholders that have a majority of the total number of votes in the Shareholders Assembly are present at the session at which these decisions are enacted.

## • Incorporation of limited liability companies and joint stock companies

### LIMITED LIABILITY COMPANIES

According to the Law on the Registration Procedure with the Business Registers Agency, the following documents are required in the incorporation procedure:

- A certificate of incorporation of the shareholders or, if the shareholder is a natural person, a copy of his/her identity card (for Serbian citizens) or passport (for foreign citizens)
- A decision on the appointment of company representatives, if it was not designated by the Memorandum of Association
- The Memorandum of Association with the founders' signatures notarised
- Proof of the contributed share capital, if the contribution was made before incorporation

### JOINT STOCK COMPANIES

According to the Law on the Registration Procedure with the Business Registers Agency, the following documents are required in the incorporation procedure:

- The Memorandum of Association, with the founders' signatures notarised
- The Articles of Association
- A certificate from a credit institution that the shares have been paid-in in cash, or an appraisal by a state licensed appraiser of the value of the in kind contributions, or a certificate issued by the competent authority of the appraisal of the value of the in kind contribution

- A decision on the appointment of the director, and/or members and chairmen of the Board of Directors, if it was not designated by the Articles of Association
- A decision on the appointment of the company's authorised representatives, if it was not designated by the Articles of Association.
- A decision on the appointment of the members of the Supervisory Board in case of a company with a two-tier management system, if it was not designated by the Articles of Association
- A decision on the appointment of the members of the Executive Board, in case of a company with a two-tier corporate governance system;

## • Competition/Antitrust Issues

The Competition/Antitrust matters in Serbia are regulated by the Competition Law (Law on the Protection of Competition, "Official Gazette of the RS", no. 51/09 and 95/13) which is in effect since the 1st of November, 2009. In short, the Competition Law regulates the merger control regime and lays down the EU-like antitrust rules. The previous law, from 2005, established the Competition Commission assigned with the main competencies needed for the implementation of the law.

### RESTRICTIVE AGREEMENTS

The Competition Law prohibits agreements between undertakings which have as their object or effect the significant prevention, restriction or distortion of competition within the territory of the Republic of Serbia. Restrictive agreements can take the form of written contracts, explicit or implicit agreements, concerted practices, decisions by associations of undertakings, and the law in particular provides examples of such agreements as follows:

- Agreements to, directly or indirectly, fix purchase or selling prices or any other trading conditions
- Agreements to limit or control production, market, technical development or investments
- Applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage
- Agreements to share markets or supply sources; and,
- Making the agreement subject to acceptance of additional obligations, which by their nature or according to commercial usage, have no connection with the subject of such contracts.

Restrictive agreements are null and void unless exempt through the application of either individual or block exemption in line with the Competition Law.

## ABUSE OF A DOMINANT MARKET POSITION

The Competition Law prescribes that an undertaking can be presumed to be in a dominant position when, due to its market power, it can act in the relevant market to a considerable extent independently of its actual or potential competitors, consumers, buyers or suppliers. Dominance is determined in relation to the relevant economic and others indicators, that include, but are not limited to: the structure of the market, actual or potential competitors, a market share above 40%, barriers to entry, a degree of vertical integration, financial and economic power etc. Similarly to restrictive agreements, examples of abuse of a dominant position provided under the Competition Law include the following: direct or indirect imposing of unjust purchase or sale prices, or of other unfair business conditions, limiting the production, market or technical development, applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage and conditioning the contract with the other party accepting additional obligations.

## MERGER CONTROL

The Law prescribes mandatory notifications that are based on turnover thresholds – a notification is required for any concentration of undertakings (mergers, acquisitions, full functional joint ventures) where the combined turnovers of the parties exceed the prescribed thresholds. Any merger, acquisition, consolidation, full functional joint venture or acquisition is regarded as a concentration of undertakings which has to be notified if it meets the thresholds. However, concentrations that are implemented through public takeover of joint stock companies must be notified even though the filing thresholds have not been met. The merger notification has to be filed prior to the implementation of concentration, but not later than 15 calendar days after:

- The conclusion of the agreement or contract
- An announcement of a public bid
- The acquisition of control

Alternatively, a merger can and should be notified at an earlier stage of the deal – upon the signing of a non-binding agreement (which does not trigger the filing deadline) – a letter of intent, a memorandum of understanding, an executive corporate decision which expresses a serious intent and is signed by both parties, etc. The Competition Law prescribes an obligation to fully suspend the implementation of the concentration prior to the obtaining of the clearance issued by the Competition Commission or prior to the expiration of the statutory waiting period.



**SANCTIONS**

Parties to anti-competitive agreements, dominant companies engaging in anti-competitive practices and parties which carry out a merger without obtaining an approval, can be fined in the up to 10% of their annual revenues realised in the previous fiscal year in the Republic of Serbia. If the parties do not file in a timely manner, a fine (a, so called, procedural penalty) ranging between EUR 500 and EUR 5,000 for each day that the filing is delayed, may be imposed by the authority.

## • Regulatory framework

The tax system in Serbia is established so as that each main type of tax is regulated by a separate piece of legislation and a number of bylaws issued based on them, including:

- Law on Corporate Income Tax
- Law on Personal Income Tax
- Law on Value Added Tax
- Law on Property Taxes (governing property tax, property transfer tax and tax on gifts and heritage)

These laws primarily deal with substantive matters in their respective tax areas, provided that they also prescribe certain specific procedural rules on tax assessment.

The system of mandatory social contributions is also established by laws enacted by the Parliament. The system is governed in the first place by a Law on Mandatory Social Security Contributions, while specific rules in relation to each of the type of social security are prescribed by the separate laws, as follows:

- Law on Pension and Disability Insurance,
- Law on Health Insurance, and
- Law on Employment and Insurance in Case of Unemployment.

In addition to the above, there are a number of laws establishing numerous so-called para-fiscal charges, such as court and administrative fees and other fees.

General rules governing the tax procedure, including the assessment and collection of tax, rights and obligations in relation to the tax system are governed by the Law on Tax Procedure and Tax Administration. Procedural rules prescribed by this law are applicable in all tax areas, unless it is otherwise prescribed by a separate law governing the specific tax area. Rules prescribed by the Law on Tax Procedure and Tax Administration are also applicable in relation to social security contributions, para-fiscal charges and other types of public revenues, unless separate laws governing these public revenues provide otherwise. Finally, since the tax procedures are

essentially administrative procedures, they are also governed by the Law on General Administrative Procedure, in the parts which are not covered by the Law on Tax Procedure and Tax Administration and separate tax laws.

International treaties are an important part of the Serbian legal system, including the area of tax and social security contributions. Ratified international treaties (bilateral and multilateral) have supremacy over national legislation.

Serbia has an extensive network of more than 50 treaties on the avoidance of double taxation treaties (DTT), including DTTs with almost all EU countries, Russia, all the regional countries and a number of Asian countries. DTTs applicable in Serbia are based on OECD Model Convention. In 2017, Serbia signed a Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). MLI is a result of the OECD/G20 Project to tackle Base Erosion and Profit Shifting (BEPS). The MLI will be applied as a part of the double tax treaties that Serbia signed after reaching the agreement with the other contracting state.

Serbia also ratified social security conventions with more than 25 countries, governing the rights and obligations in relation to the social security of the citizens of these countries in Serbia and vice versa.

Finally, an important source of tax law in Serbia are also international treaties governing other issues – primarily the status of international organizations and financial institutions or the development and financing of important infrastructural projects, which provide for specific tax rules in the areas covered by the treaties. These rules are primarily related to various tax exemptions.

The main authority in charge of the enforcement of tax laws in Serbia is the Tax Authority – being the authority within the Ministry of Finance. The Tax Authority is in charge for: the registration of taxpayers, assessment of tax, tax control, collection of tax, investigations of tax criminal offences and so on.

The Compulsory Social Insurance Central Register was established in 2010 in order to maintain the registry of contribution payers, users of insurance and all changes regarding the information on these entities. Contribution payers are obliged to electronically register any relevant change with the Central Register. The Central Register further distributes information to individual social insurance funds, the Tax Authority and other bodies with an interest in the database maintained by the Central Register.

## • Personal income tax and social security contributions

Rules governing the taxation of personal income are prescribed by the Law on Personal Income Tax (PIT Law) and the accompanying secondary regulations with the PIT Law. As a general note, the Serbian system of personal income tax is based on the so-called cedular system of taxation: different types of income are taxed at different tax rates and different rules for the assessment of the tax base. At the end of the year, resident tax payers whose annual income generated throughout the year from all sources exceeds the threshold prescribed by the PIT Law are required to pay additional annual income tax.

### TYPES OF INCOME SUBJECT TO PERSONAL INCOME TAX

The main types of income for which the PIT Law prescribes specific rules of taxation include salaries, the income of entrepreneurs, income from immovable property, income from capital (dividend, interest) capital gains, royalties, and “other income” which is a residual category including any income not included in one of the specified categories (including also income generated by natural persons under service agreements).

Below we have presented the system for the taxation of salaries, as the most common type of personal income.

### TAXATION OF INCOME FROM LABOUR

Salary tax is levied at a 10% tax rate applicable on the gross amount of salary decreased by the monthly non-taxable amount of RSD 11.790 (app. EUR 100).

The taxable person is the employee, but the employer is responsible for calculating and paying personal income tax on behalf of his employees. The taxable base is the gross salary, which includes salary tax and social security contributions. Benefits in kind, such as the use of company vehicles or apartments, as well as income from employment share plans are subject to salary tax.

Specified types of income, up to a prescribed amount, are exempt. They include public transportation costs for home to office travel and daily allowances for business trips. Also, insurance premiums for private pension and health insurance paid by the employer for its employees are exempted from the prescribed threshold (app. EUR 50 per month).

The employer who is employing individuals registered at the National Agency for Employment as unemployed, may ask for a refund of paid taxes and contributions in the range between 65% and 75% depending on the number of employed individuals.

## SOCIAL SECURITY CONTRIBUTIONS

Salaries (and other similar types of income generated from work) are subject to an obligation to pay contributions for mandatory social security insurance (including social security contributions due by the employer and those due by the employee). The rates of social security contributions due on salaries are as follows:

<b>Pension and disability</b>		<b>Health</b>	<b>Unemployment</b>
Employer's portion	12%	5.15%	0.75%
Employee's portion	14%	5.15%	0.75%
Total	26%	10.3%	1.5%

The base for social security contributions paid on salaries is subject to limitation as to the maximum monthly base of app. EUR 2,500, while the maximum annual base related to annual income generated from all sources is estimated at app. EUR 31,500 for 2016.

Tax and social security contributions are payable by the employer on the withholding basis if the employer is a resident legal entity. In this case the employer is required to pay salary tax and social security contributions on each salary payment. The tax return for withholding tax has to be filed electronically before the payment of personal income.

## ANNUAL INCOME TAX

In addition to the tax on specific types of income paid during the year, tax residents and non-residents, whose total annual income exceeds three times the annual average salary in Serbia (for 2016 app. EUR 19,000) are required to pay an annual income tax.

The tax base for annual income tax is equal to the sum of all income generated during the year (with certain exemptions, such as dividends and capital gains) reduced by a non-taxable amount (three times the average salary) and the standard deductions for taxpayers (40% of the average salary) and for the members of taxpayer's family (15% of the average salary for each family member).

Tax rates for annual income tax are progressive:

- 10% for tax base up to six times the average annual salary in Serbia (for 2016 app. EUR 38,000)
- 15% for tax base exceeding six times the average annual salary

The tax returns should be filed by the 15th of May for the income generated in the previous year. The tax returns may be filed electronically or in hard copy.

## THE POSITION OF FOREIGN NATIONALS WITHIN THE SERBIAN TAX SYSTEM

The scope of tax liabilities of any natural person depends on whether such a person is a resident of Serbia or not. Residents of Serbia are liable to personal income tax on their worldwide income. Non-residents are liable to pay tax only on income earned in Serbia.

The residency of a natural person is established on the basis of criteria prescribed by the PIT Law. Under these rules an individual will be considered a resident of Serbia if one of the following is fulfilled:

- He/she resides in Serbia more than 183 days during a period of 12 months which begins or ends in the given fiscal year
- He/she has a domicile or centre of his/hers vital interests in the territory of Serbia

Residents of Serbia are required to pay tax on their world-wide income, irrespective of the source of their income. Non-residents are required to pay tax on income generated in Serbia.

In addition to salary tax, foreign staff may be required to pay social security contributions on their salaries while they work in Serbia. This obligation may be eliminated on the basis of a convention on social security insurance.

### • Corporate income tax

CIT is governed by the Law on Corporate Income Tax (CIT Law). In addition to general rules prescribed by the CIT Law, rules governing the taxation of corporate profit are also prescribed by the secondary regulations prescribed by the Ministry of Finance.

#### PERSONS SUBJECT TO THE TAX

Companies incorporated in Serbia are Serbian tax residents and are therefore required to pay tax on their worldwide income. Serbian non-residents have to pay CIT only for the part of the income which is attributable to the activity of the permanent establishment constituted in Serbia and on certain types of income deemed to be generated in Serbia (see section Withholding tax below).

#### TAX RATE

Corporate income tax is levied at a 15% flat rate.

**TAX BASE**

The tax base is assessed on the basis of the profit (revenues and expenses) declared by the taxpayer in his annual income statement (profit and loss account), prepared in accordance with International Accounting Standards (IAS), and adjusted in accordance with the rules prescribed by the CIT Law.

Generally, an expense will be recognized for tax purposes if it is documented and incurred for business purposes.

Certain types of expenses specifically listed in the law are non-deductible, while the deductibility of certain expenses is limited, so as that the threshold for deductibility is set as a percentage of the taxpayer's annual revenues (for example, expenses for health, cultural, educational, scientific, humanitarian, purposes and similar)

The deductibility of certain types of expenses is allowed only subject to the fulfilment of certain conditions. For example, the write-off of receivables will be recognized for tax purposes only if the taxpayer filed a lawsuit against the debtor of such receivable (or if the costs of court procedures exceed the value of the receivable which is written-off), while certain types of expenses are recognized only up to the paid amount (such as public charges which are not dependent on the business operation results).

Expenses on the basis of an impairment of assets are not deductible, but may be deducted in the year in which the asset was transferred, used, or in which such an asset was damaged due to force majeure.

The deductibility of other expenses is limited in accordance with the specific rules on tax depreciation, transfer pricing, rules governing thin capitalization, etc.

**TAX DEPRECIATION**

An asset may be depreciated for tax purposes if it is recognized as a fixed asset under the relevant accounting regulations (IAS) and subject to the condition that its useful life is longer than one year. Goodwill cannot be depreciated.

All assets are categorized in five depreciation groups with different rates and methods of depreciation for tax purposes. Tax depreciation rates range from 2.5% (for immovable assets) to 30%. Immoveable assets are depreciated using a proportional method, and all other assets under the declining method.

**THIN CAPITALIZATION**

The deductibility of interest generated from related party loans is subject to limitation on the ground of thin capitalization. Under the thin capitalization rules, debt to equity ratio for the deductibility of interest on related-party loans for companies

is four times the taxpayer's capital (exceptionally, ten for banks and financial institutions). The coefficient of deductible interest is calculated by dividing the amount of four times the average amount of capital by the average daily amount of loans from related parties.

## TRANSFER PRICING RULES

Transfer-pricing obligations of the Serbian taxpayers include, first, the obligation to disclose the value of expenses and revenues generated in transactions from related parties at agreed (transfer) prices and at arm's length prices, and to include the difference in the taxable profit. Note that transfer pricing obligations apply equally to both transactions between Serbian resident taxpayers and cross-border transactions between Serbian taxpayers and their foreign related parties.

The definition of related parties is set in a very broad manner: for the purposes of transfer pricing rules, a party related to the taxpayer shall be deemed to be any entity (foreign or Serbian) which holds, directly or indirectly, more than a 25% share in capital or voting rights in the taxpayer. Likewise, an entity shall be deemed to be related to a taxpayer if such an entity is controlled, directly or indirectly, by the same entities which exercise control over the taxpayer by means of the minimal 25% (direct or indirect) participation in their capital or voting rights.

The arm's length prices should be established in accordance with one of the transfer pricing methods allowed under the CIT Law. Latest amendments to the CIT Law allow all transfer pricing methods which are allowed under the OECD Transfer Pricing Guidelines, including the following:

- The comparable uncontrolled price method
- The cost-plus method
- The resale price method
- The transactional net margin method
- The profit split method

There is no hierarchy between the available transfer pricing methods, and the taxpayer is free to choose any method which it finds most appropriate for a given transaction or a group of transactions. Moreover, the taxpayer may use any other method for assessment of arm's length prices if the methods prescribed by the law are not suitable in a particular situation.

For transfer-pricing purposes, the amount of deductible interest from related party loans (deposits) may be established in two principal ways: on the basis of the market interest rates established by the NBS and published by the Serbian Ministry of



Finance, or on the basis of some of the transfer-pricing methods allowed under the CIT Law.

The Ministry of Finance publishes the arm's length interest rate in the beginning of the year for the previous year. For 2017 the amount of arm's length interest for long-term loans in EUR was set at 4.25%, while the rate for long-term loans denominated in USD is 5.72%.

#### **TAX-LOSS CARRY-FORWARDS**

Tax losses may be carried forward and offset against taxable profit in future tax periods, but for no more than 5 years.

#### **CAPITAL GAINS/LOSSES**

For tax purposes, capital gains may be generated from the disposal against a consideration of immoveable assets, shares, IP rights and investment units. Note that capital gains/losses generated in transactions with related parties are also subject to transfer pricing rules, so that the sale price of assets sold to a related party is the arm's length price (if the agreed price is lower than the market price).

Capital gains may be offset only against capital losses incurred in the same year. Unused capital losses in the current tax year may be carried forward and offset against capital gains in the following five years.

#### **TAX INCENTIVES**

The CIT Law provides tax credit for the investment in new fixed assets and the employment of new employees.

The taxpayer which invests or in whose new fixed assets another entity invests more than RSD 1 billion (app. EUR 8.3 mil.), and which employs at least 100 new employees during the period of investment, has the right to the reduction of tax proportionally to the participation of the new fixed assets in the existing fixed assets, for a period of ten years. The tax credit starts to apply in the year in which the taxpayer starts to generate taxable profit.

#### **THE ADMINISTRATION AND PAYMENT OF CIT**

Corporate income tax is paid on the basis of the annual tax balance and tax return in which the taxpayer should declare the amount of his taxable profit (tax balance) and the amount of tax due.

The tax period for which the tax is assessed and paid is a calendar year, provided that in certain cases the tax year may be different than the calendar year.

The deadline for the submission of tax balance and tax returns is 180 days starting from the end of the year for which the tax is assessed, i.e. until the end of June of the current year for the preceding year. Along with the CIT return, the taxpayer is required to file transfer pricing documentation. Newly incorporated companies are also required to file a provisional CIT return within 15 days after the registration.

CIT is paid in advance, in monthly (provisional) instalments, calculated on the basis of the amount of tax declared in the previous year. Monthly instalments have to be paid by the 15th of the current month for the previous month.

The amount of tax paid by the taxpayer throughout the year on the basis of the profit made in the previous year is adjusted at the end of the year in accordance with the actual profit made during that year. At the end of the year the taxpayer is required to pay the difference (or request a refund), depending on whether the total amount of monthly instalments paid during the year is higher or lower than the amount of tax due on the basis of profits in the current year.

## **WITHHOLDING TAX**

Withholding tax is payable on the following types of income paid by resident taxpayers to non-resident entities abroad:

- Dividend
- Interest
- Royalties
- Income from rent of moveable and immovable property located in Serbia
- Service fees

The tax base for withholding tax is a gross income which incorporates withholding tax.

The standard withholding tax rate is flat 20%. The higher 25% tax rate applies to interest, royalties, rental income and service income paid to an entity from the jurisdiction that has the status of a tax haven.

Withholding tax may be eliminated or reduced on the basis of a double tax treaty between Serbia and recipient's country of residence. Most tax treaties prescribe lower tax rates for dividends, interest, royalties, and rental income. Also, most treaties

prescribes that the service income is subject to tax only in the service provider's country of residence. The tax rate has to be filed even in cases when the relevant income is exempted from the withholding tax.

Beneficial tax rates available under the double tax treaties apply subject to the condition that a non-resident recipient of income obtains the certificate of tax residency (confirming that the recipient of the income is a resident of a treaty country) and delivers it to the Serbian payer of income. In addition, a non-resident has to demonstrate that it is a beneficial owner of the income.

Withholding tax has to be paid at the same moment when the income is transferred to a non-resident entity.

## • Property taxes

Property transfer tax (PTT) is a one-off tax payable on the transfer against the consideration of a property under certain specific types of assets, including immovable assets, IP rights, and used motor vehicles. The PTT applies only if the sale of assets is not subject to VAT. PTT is levied at the rate of 2.5% on the tax base which is equal to an agreed price or the market price of asset. The PTT is due by the seller of the asset, cannot be refunded and represents a pure cost for the taxpayer. Gifts and inheritance by direct descendants and spouses are not taxed. Also, gifts below RSD 100,000 (app. EUR 800) in one year are non-taxable. The tax rate of 1.5% is applied for transfers from relatives in the second order of inheritance, while the rate of 2.5% for transfer of property by the relatives in the third order or any other person.

Owners of immovable assets located in Serbia are required to pay an annual property tax on such immovable assets to the municipality on whose territory the immovable asset is located. The applicable tax rate varies depending on the municipality, provided that it cannot exceed 0.4% for corporate taxpayers. The tax base is the fair value of the immovable asset for taxpayers that keep books using the "fair value method" or a market value established by the Tax Administration for other taxpayers. Tax due is assessed by the Tax Administration, on the basis of the tax return filed by the taxpayer and is payable quarterly.

## • Value added tax

The Serbian VAT system is modelled after the EU VAT Directive, and the majority of general VAT principles applicable throughout the EU apply also in Serbia. Serbian VAT is regulated by the Law on Value Added Tax (VAT Law), and a number of VAT regulations which prescribe detailed rules for the implementation of general rules of the VAT Law.

### TAXABLE PERSONS

A taxable person is an entity (legal and natural persons) who independently carries out the supply of goods and services, within its business activities.

Only registered VAT taxpayers are required to pay VAT on their supplies of goods and services, and have the right to deduct input VAT charged to them by their suppliers. Taxable persons whose turnover in a 12-month period exceeds, or will exceed, RSD 8,000,000 (app. EUR 67,000) are required to register for VAT. Entities whose turnover does not exceed this threshold may register for VAT, but are not required to.

### TAXABLE TRANSACTIONS

Transactions subject to VAT include the following:

- The supply of goods and services. A supply of goods/services will be subject to VAT only if made on the territory of Serbia (as defined by the place of supply rules, depending on the specific type of supply) and if made for consideration (though, in certain cases, supplies made without consideration will also be subject to VAT).
- The import of goods.

The VAT Law prescribes the list of exemptions from VAT, including two main principal groups of exemptions:

- Exemptions with the right to a deduction of input VAT (0% rates supplies), such as the export of goods, supplies made under international loan or donation agreements, international transport and similar.
- Exemptions without the right to a deduction of input VAT, including primarily public and financial services, but also a supply of land (agricultural, forest, or construction land).

## **TAX BASE AND TAX RATES**

The standard VAT rate is 20%. Certain goods and services (such as the supply of groceries, medicines, newspapers, utility services, etc.) are taxed at a reduced VAT rate of 10%.

The tax base for the assessment of VAT constitutes everything that the taxpayer received or will receive from the customer in consideration for the supply.

## **THE DEDUCTION OF INPUT VAT**

Registered VAT taxpayers are entitled to deduct their input VAT from the output VAT, subject to the following main conditions:

- input supplies are used for the purpose of taxable output turnover
- the taxpayer holds an invoice of the supplier drawn in accordance with the formal invoicing requirements prescribed by the VAT Law.

The excess of input VAT in the given VAT period may be used as credit to offset the due in the following tax periods, or the taxpayer may request a refund of such VAT.

## **ADMINISTRATION AND PAYMENT OF VAT**

For taxpayers whose turnover in a 12-months period exceeds RSD 50 million (app. EUR 415,000), the tax period is a calendar month. Taxpayers whose turnover does not exceed this threshold are required to account and pay VAT quarterly.

The deadline for the submission of VAT returns and the payment of VAT for taxpayers whose VAT period is a calendar month is the 15th of the month for the previous month. For taxpayers whose VAT period is quarterly, the deadline for the submission of VAT returns and the payment of VAT is the 20th of the current month for the preceding quarter.

## • Double taxation treaties

In the table below is a list of double tax treaties signed by Serbia:

Country	Dividends	Interest	Royalties
Albania	15/5	10	10
Armenia	8	8	8
Austria	5/15	0/10	5/10
Azerbaijan	10	0/10	10
Belgium	10/15	15	10
Belarus	5/15	8	10
Bosnia and Herzegovina	5/10	0/10	10
Bulgaria	15/5	10	10
Canada	5/15	10	10
China	5	0/10	10
Croatia	5/10	10	10
Cyprus	10	10	10
Czech Republic	10	0/10	5/10
Denmark	5/15	0/10	10
Egypt	5/15	15	15
Estonia	5/10	0/10	5/10
Finland	5/15	0	10
France	5/15	0	0
Georgia	5/15	0/10	10
Ghana*	5/15	10	10
Greece	5/15	10	10
Germany	15	0	10
Hungary	15/5	10	10
India	5/15	0/10	10
Indonesia*	15	0/10	15
Iran*	10	0/10	15
Ireland	5/10	0/10	5/10
Italy	10	10	10
Kazakhstan	10/15	0/10	10
Kuwait	10/5	10	10
Latvia	5/10	0/10	5/10
Libya	5/10	0/10	10
Lithuania	5/10	0/10	10
Luxembourg	5/10	0/10	5/10
Macedonia	15/5	10	10
Malaysia	0 for Serbian residents	10	10
Montenegro	10	0/10	5/10
Morocco*	10	0/10	10
Netherlands	5/15	0	10

Country	Dividends	Interest	Royalties
Norway	0/5/15	0/10	5/10
North Korea	10	0/10	10
Poland	5/15	10	10
Pakistan	10	0/10	10
Palestine*	10	0/10	10
Qatar	5/10	0/10	10
Romania	10	0/10	10
Russia	5/15	10	10
Slovak Republic	5/15	10	10
Slovenia	5/10	0/10	5/10
South Korea	5/10	0/10	5/10
Spain	5/10	0/10	5/10
Sri Lanka	12.5	10	10
Sweden	5/15	0	0
Switzerland	5/15	10	10
Tunisia	10	10	10
Turkey	5/15	0/10	10
Ukraine	5/10	0/10	10
United Arab Emirates	0/5/10	0/10	10
United Kingdom	5/15	10	10
Vietnam	10/15	10	10
Zimbabwe*	5/15	10	10

\* In the table below is a list of double tax treaties signed by Serbia:

## • Excise

Excise duties are levied on the producers and importers of the following goods:

- Oil derivatives
- Biofuel and bio fluids
- Tobacco products, including tobacco products that are heated during use but do not burn
- Alcohol beverages
- Coffee
- Fluids for the filling of electronic cigarettes
- Electricity for final consumption

Exported excisable goods are considered exempt. Oil derivatives, biofuel and bio fluids supplied by the producer or importer are also exempted excisable goods, if so is provided by an international agreement.

Excise duty is levied as a fixed amount (RSD) per unit quantity. The Excise Law prescribes special provisions for tobacco. There are two types of excise duty:

## FIXED AMOUNT PER PACK

In the meanwhile, Serbia introduced the same excises both for cigarettes imported in Serbia and cigarettes produced in Serbia. The fixed amount of the excise will be payable per pack of 20 cigarettes as follows:

- For period as from 1 July until 31 December of 2017: 65.50 RSD/pack
- For period as from 1 January until 30 June of 2018: 67.00 RSD/pack
- For period as from 1 July until 31 December of 2018: 68.50 RSD/pack
- For period as from 1 January until 30 June of 2019: 70.00 RSD/pack
- For period as from 1 July until 31 December of 2019: 71.50 RSD/pack
- For period as from 1 January until 30 June of 2020: 73.00 RSD/pack
- For period as from 1 July until 31 December of 2020: 74.50 RSD/pack

## PROPORTIONAL EXCISE DUTY

The proportional excise duty will be introduced along with excises above in the amount of 33% of retail price, determined by either the producer or the importer of cigarettes.

Separate excise, calculated as 43% of retail price per kilogram, is payable on tobacco and other tobacco products.

## • Customs

### REGULATORY FRAMEWORK

The rules governing the system of foreign trade in goods in Serbia are established by several laws enacted by the Serbian Parliament, including, in particular, the following:

- The Law on Foreign Trade, establishing the fundamental foreign trade principles
- Customs Law, prescribing the rules for the conduct of the customs procedure
- The Law on Customs Tariff, establishing the customs tariffs used for the calculation of customs duties
- The Law on Foreign Exchange Operations, governing the terms and conditions for the execution of payments between residents and non-residents



The main principles governing foreign trade, established by the Law on Foreign Trade, include the following:

- National treatment
- Publicity
- Confidentiality
- Freedom of foreign trade
- Non-discrimination
- Most favoured nation treatment
- The prohibition of quantitative import/export restrictions, save for those established by the law

Serbia has a wide range of free trade agreements which provide for the preferential customs treatment of goods originating from the signatory countries. The most important free trade agreements include the following:

- Free Trade Agreement with European Free Trade Association (EFTA)
- Free Trade Agreement with Turkey (FTAT)
- Free Trade Agreement with Kazakhstan (FTAK)
- Central Europe Free Trade Agreement (CEFTA), a multilateral treaty, applicable in Albania, Bosnia and Herzegovina, Croatia, Macedonia, Moldova and Montenegro
- Interim Trade Agreement with the European Union (ITA)
- Free Trade Agreement with the Russian Federation (FTAR)

Serbia does not, however, have free trade agreements with the USA and Japan in place.

## THE INSTITUTIONAL FRAMEWORK

The main authority in charge of the enforcement of customs regulations in Serbia is the Customs Administration, being an authority within the Ministry of Finance. The Customs Administration is in charge of: customs clearance, customs supervision and other activities in relation to the control of foreign trade in goods and services.

## CUSTOMS PROCEDURE

As a general rule, in order to be imported in Serbia, foreign goods have to go through a customs procedure prescribed by the Customs Law.

After the goods cross the Serbian border, the entity which brought the goods on the territory of Serbia is required to present them to the customs authorities and take them to the organizational unit of the Customs Administration or other place designated by the Customs Administration. Together with the delivery of goods, a summary declaration has to be submitted to the Customs Administration.

After the goods have been presented to the Customs Administration, they are kept in temporary storage until they are assigned to a customs approved treatment, or their use is approved. There are several types of customs approved treatment, including:

- The placing of goods under a customs procedure
- Re-export
- The handing over of goods in favour of the Republic of Serbia
- Entry into a free trade zone or free storage
- The destruction of the goods

The customs authorities have to decide about customs approved treatment or use within 20 days following the submission of the summary declaration.

As specified above, in order to be imported in Serbia, the goods have to be placed under a customs procedure.

The customs procedure is subject to the submission of the customs declaration to the customs authorities by the importer on record. The importer on record may only be a Serbian entity. Foreign entities participating in the customs procedure have to appoint their representatives in Serbia.

The customs declaration has to be prepared on the “JCI” form prescribed by the Serbian regulations. All goods which are placed under the customs procedure have to be included in the customs declaration. The declaration should contain sufficient information (type of goods, quantity, value, etc.) for the calculation of customs duties. Information in the customs declaration has to be supported by appropriate documents, such as agreements, invoices, purchase orders, waybills, etc.

## CUSTOMS DUTIES

The customs duties are calculated by the application of the appropriate customs rate on the customs value of the goods.

Customs rates are established by the Law on Customs Tariff and the bylaws issued on the basis of this law, and depend on the type and purpose of the goods.

Custom rates established by the national legislation may be lower or eliminated on the basis of free trade agreements concluded between Serbia and the country of origin of the goods which are being imported (the, so called, preferential origin). Terms and conditions for the recognition of preferential origin are prescribed by the respective free trade agreements. The free trade agreements also prescribe documentation which is used as evidence of the preferential treatment, such as “EUR1” form under ITA.

The customs value of goods is consideration paid (or to be paid) by the importer in return for the goods (transaction price), increased for the following costs:

- Costs borne by the importer in relation to the goods which have not been included in the transaction price
- Goods supplied by the importer in relation to the production of goods without or at lower consideration

- Royalties paid in relation to the goods, if they are not included in the transaction price
- Amounts obtained from further sale of imported goods which are paid to the exporter, if such amounts can be established
- Costs of transport, services in relation to the transport, and insurance of goods until they crossed the Serbian border

In transactions between related parties, the Customs Administration will accept the transaction price as customs value only if the relationship between the importer and exporter did not have an impact on the establishment of the transaction price. Otherwise, the Customs Administration will not accept the transaction price as the customs value and will establish customs value itself, in line with the Customs Law. The customs duties become due at the moment that the Customs Administration accepts the customs declaration.

### **MODALITIES OF IMPORT**

Two main modalities of the import regime in Serbia are the permanent import and temporary import.

Permanently imported goods are granted the status of domestic goods and therefore may be placed in free circulation on the Serbian market. The importer on record is required to pay the full amount of customs duties and import VAT due on the import of goods under the general rules.

Temporary import is allowed for the goods which are brought in Serbia with the intention of being exported in an unchanged condition. Temporarily imported goods do not acquire the status of domestic goods.

The goods may be temporarily imported subject to the approval granted by the customs authorities. The approval will be granted only if the goods are readily identifiable. Otherwise, the goods may only be permanently imported.

The customs authorities decide about the duration of the temporary import, provided that it cannot exceed 24 months. As an exemption, this deadline may be extended if necessary in order to realize the purpose of import. If the goods are not exported within the time limit, the importer has to pay the customs duties and VAT that would have been payable if, when the goods were imported, the goods had not been treated as temporary imports.

The customs duties for temporary import are set at 3% of customs duties which would have been paid on the permanent import, for each month in which the goods were under the temporary import regime. Exceptionally, certain goods explicitly prescribed by the Government are exempt from customs duties in case of temporary import.

# Serbia | LABOUR LAW

The Labour Law (“Official Gazette of the Republic of Serbia”, no. 24/2005, no 61/2005, no. 54/2009, no 32/2016, no 75/2017 and no 13/2017) is the centrepiece of Serbian regulation in the field, and sets out the main rights and obligations of employers and employees. The provisions of the Law apply to the employees working on the territory of the Republic of Serbia for a domestic or foreign legal or natural person, as well to those employees that the employer has sent abroad and the foreigners working on the territory of Serbia, unless otherwise prescribed by the Law. Labour issues in Serbia are also regulated by several other laws:

- Law on Pension and Disability Insurance
- Law on Health Insurance
- Law on Employment and Unemployment Insurance
- Law on Mandatory Social Contributions
- Law on Financial Aid to Families with Children
- Law on Social Protection
- Law on Labour Safety and Health Protection
- Law on Health Protection

## • Employment contracts

Pursuant to the Labour Law, all employment contracts must be concluded in writing, before the commencement of work. They have a certain minimal content and represent the basis of the individual labour relationship between the employer and the employee. They cannot be entered under terms which are less favourable to the employee than those set out under the applicable Collective Bargaining Agreements and the Labour Law.

Under the Serbian Labour Law there are two types of employment relations, a definite and an indefinite employment relation. Definite term employment may be concluded only in cases specified in the Labour Law, for a maximum duration of 24 months (there are some specific exceptions when duration may be longer, e.g. due to the replacement of an absent employee or work on a project).

The Labour Law provides that the director or other legal representative of the company can be engaged on the basis of an employment agreement or, alternatively, through a non-employment Management Agreement. If a director is engaged

through an employment agreement, such an agreement may be concluded either for an indefinite or definite term— for the duration of his/her term of office, in line with the foundation enactments. If a director is engaged through an out-of-employment Management Agreement, limitations of the employment relation do not apply to such agreement. The parties are free to agree on the amount of remuneration and any other mutual rights and obligations that they deem adequate.

The company (employer) may also conclude certain out-of-employment contracts, such as a service agreement and the agreement on temporary and periodic work. Both should be concluded in writing.

An agreement on temporary and periodic work is an agreement concluded for a limited period of time (up to 120 days per calendar year) with a person who will perform the activities that fall within the scope of the activities of the company engaging such person. This contract can be concluded only with certain persons (unemployed persons, part-time employees or retired persons).

A service agreement is an agreement concluded for the performance of independent intellectual or physical work for the company, whereas such activity falls outside the scope of activities that the company performs. There is no time limit as to the length of such an agreement.

The Labour Law prescribes also a possibility for the employer to engage persons through other out-of-employment agreements such as: an agreement on professional training (this agreement can be concluded with trainees or other persons that wish to be further specialised in their profession; the employer may provide pecuniary remuneration for these persons, but this is not considered a salary), an agreement on additional work (an employee working full working hours may enter into an agreement on additional work with another employer, for up to 1/3 of full working hours).

## • Legal Grounds for Dismissal

The employer and the employee may terminate their employment relations in the manner prescribed by the Labour Law. In general, employment can be terminated in the following cases: upon the expiry of the agreed term; when the employee fulfils pension retirement conditions; by mutual consent of the employer and the employee; by dismissal (only in cases specified in the Law); upon the death of the employee; at the request of the parents or guardians of an under-aged employee and in other cases prescribed by the Labour Law (loss of working ability, official

prohibition of further work activities, prison sentence, termination of employer's business activities).

Regarding unilateral dismissals, as one of the most frequently used reasons for the termination of employment, the employer may dismiss an employee only if there is a justified reason related to an employee's work abilities or his/her behaviour, as follows:

- If an employee underperformed or did not have the required knowledge or abilities for the performance of work for his/her work position ("professional inadequacy")
- If an employee has been finally sentenced for a criminal act in relation to work
- If an employee did not return to work within 15 days as of the date of expiry of his/her unpaid leave or employment dormancy period
- If an employee disrespected work discipline prescribed by the law or employer's enactment, or if his behaviour is such that it cannot be allowed that he/she continues to work for the employer
- If, due to economical, technological or organisational changes, the need for the performance of certain work is terminated, or if the work load decreases (redundancy)
- If the employee refuses to enter into an annex of the employment contract (related to a change of his/her salary, work position or place of work)

## PROCEDURAL CONSIDERATIONS

In order to effect a valid termination of employment, the employer must observe a number of procedural issues that differently apply depending on the circumstances of the particular case:

- Prior warning
- Time-bar for dismissal
- Redundancy related procedural issues
- Trade Union opinion (non-binding)
- Termination notice requirements

## NOTICE PERIOD

When dismissed for professional inadequacy, the employee will be entitled to a notice period of between eight and thirty days (depending on the total amount of time for which the employee has been a member of the social security system). The employee and the employer may agree to shorten or cancel such notice period on the condition that the employee is fully compensated for the entire duration of the notice period.

The Labour Law also mandates that the employee, when terminating employment on his/her own, provides a notice period of a minimum of 15 and a maximum of 30 days.

Apart from the situations noted above, no additional notice period is mandated by the Labour Law. However, if internal employment enactments or employment contract set a notice period, such notice period should be considered in a separate case.

### **SEVERANCE PAYMENT**

When dismissed due to technological, economical or organisational changes (redundancy) the employee is entitled to a severance payment in the amount determined in the employment agreement or the employer's general act. However, this payment cannot be less than 1/3 of the monthly gross salary per each year of work with the employer (and its affiliates); having in mind the average gross total monthly salary paid in the last 3 months (including bonuses and other mandatory payments considered as salary).

Apart from severance in the case of redundancy, no other severance pay is mandated by the Labour Law. However, if internal employment enactments or employment contract set for a severance pay in a particular case, such severance should be considered.

As the Serbian Labour Law is still slightly protective with respect to employees, and the Serbian courts tend to be favourable towards employees, it is of the utmost importance, in order to ensure that no valid employees' claims emerge with regard to the dismissal procedure, to strictly abide by the procedural requirements in each particular case. We would therefore advise that the assistance of legal counsel is required in every particular dismissal case.

### **• Employees' representatives and union representation**

Employees of an employer with more than 50 employees may form an employees' council, in accordance with the collective agreement. Freedom to organise in trade unions and trade union activity shall be guaranteed to employees. Trade unions are established to protect the rights and promote the professional and economic interests of their members. A trade union shall be established by the making of a relevant entry into the trade union register kept by the ministry in charge of labour affairs and shall require no approval. Trade unions shall be entered into the register in accordance with the law and other regulations. Trade union representativeness, for the purpose of this Law, shall be determined by:

- Entry into the register, in accordance the law and other regulations
- In respect to the number of members verified through membership application forms
- If it is established and operates on the principles of the freedom of union representation
- If it is independent of state authorities and employers
- If it is financed predominantly from membership fees and other own resources

A union having a minimum of 15% of the employees of an employer shall be deemed a representative trade union for concluding a collective agreement. A representative trade union for concluding a collective agreement at the republic level, and/or unit of territorial autonomy or local self-government, shall be considered a trade union having a minimum of 10% of employees in the branch or line of business for which the collective agreement is made, and/or of the total number of employees for concluding a collective agreement covering all the employees on the territory of a given territorial unit.

For the purpose of this Law, an association of employers with membership of a minimum of 10% of the employers in the branch or line of business for which the collective agreement is concluded, and/or of the total number of employers on the territory of a given territorial unit, shall be considered as a representative association of employers. In the case of concluding a General Collective Bargaining Agreement, the representative association of employers is an association encompassing 10% of the total number of employers on the territory of the Republic of Serbia provided its members employ at least 15% of the total number of employees on the territory of the Republic of Serbia.

If the conditions of representation in the terms of Articles 218–220 of this Law are not met by any of the trade unions, and/or by an association of employers specified in Articles 221 and 222 of this Law, the trade unions and/or employers may conclude an agreement on association in order to participate in concluding a collective agreement.

## • Collective bargaining agreements

The conclusion of collective agreement is voluntary. Collective agreements regulate rights, obligations and responsibilities in the field of labour relations. A collective agreement may be concluded as:

- **General** - for the territory of the Republic of Serbia (currently there is no such General Collective Bargaining Agreement in place)
- **Special** - for the territory under local government or a unit with territorial autonomy, or within a special industry branch
- **Individual** - with the employer



A collective agreement may be concluded between an employer or a representative employers' association and a representative trade union. Parties to the collective agreement are required to bargain. A bargaining board shall be established if several representative trade unions and/or associations of employers, participate in concluding a collective agreement for the territory of the Republic or unit of territorial autonomy or local self-government. Representatives of trade unions and employers' associations participating in bargaining for concluding a collective agreement and who conclude the collective agreement have to be authorised by their respective bodies. Collective agreements shall be directly implemented and shall be binding for all employers who at the time of the conclusion of the collective agreement were members of the employers' association - party to the collective agreement. A collective agreement shall be binding also for employers who subsequently became members of the association of employers - party to the collective agreement, as of the time of joining the association of employers. The Government may, for justified reasons, decide that the collective agreement or some provisions thereof shall also apply to employers who did not participate in the concluding of the collective agreement or have not become party thereof subsequently, in order to implement economic and social policy in the Republic. An individual collective agreement shall also be binding to the employees of an employer who are not members of a trade union - signatory to the collective agreement.

The previous General Collective Bargaining Agreement ceased to be valid as of September 2005, and the new one has not been yet concluded. There are only a few special Collective Bargaining Agreements in place – such as the Collective Bargaining Agreement for Agriculture, Tobacco, Food and Water Industry, the Collective Bargaining Agreement for Road Industry, the Collective Bargaining Agreement for Construction and Construction Material Industry etc. However, these agreements currently apply only to the signatory parties. The Labour Law grants a clear preference for the regulation of labour relationships by way of a Collective Bargaining Agreement. However, in certain instances, this is not possible: 1) if a trade union is not established at the employer, or no trade union meets the threshold for representation or no agreement of association of unions in conformity with the law is not concluded; 2) if no participant to the Collective Bargaining Agreement initiates the negotiations for entering into the same; 3) if the parties to negotiations fail to agree within a maximum of 60 days from the day that the negotiation began; and 4) if the employer invites the union to negotiations and the latter fails to respond within 15 days. In such situations the labour rule book can regulate labour relationships. The labour rule book is passed by the board of directors/\_management of the company and is thus a unilateral act. As soon as the individual Collective Bargaining Agreement enters into force, the labour rule book shall cease to apply.

## • Wages and other types of compensation

### EARNINGS

An employee shall be entitled to an appropriate salary determined in accordance with the law, general act or contract of employment. An employee shall be entitled to equal salary for the same work or work of equal value performed with an employer. According to the Labour Law, it is not possible to determine a fixed amount of the salary, as the Labour Law provides for a rather complex mandatory structure of the salary and numerous mandatory payments. The salary shall include the salary effected for work performed and time spent at work, bonus earnings, compensation of salary and other incomes. Elements for and the manner of determining the earnings shall be defined in a general act or contract of employment.

### SALARY FOR THE WORK PERFORMED

Salary for the work performed and time spent at work consists out of: the basic salary (based on conditions of work set for the job in question), performance part of the salary (based on the quality and quantity of the work performed and employee's relation towards work) and increased salary.

### INCREASED SALARY

An employee shall be entitled to an increased salary pursuant to a general act or contract of employment, in the following cases:

- For overtime work: at least 26% of the basic salary
- Annual increases for the length of service with the employer and its affiliates (seniority increase): 0.4% of the basic salary for each year of employee's service with the specific employer (including employer's related companies)
- Work on public holidays: at least 110 % of the basic salary
- Night work (if this work was not considered in establishing the basic salary)- at least 26% of the basic salary

A general act or contract of employment may determine other cases in which an employee shall be entitled to increased earnings. Those earnings shall be paid out within the periods determined by a general act or contract of employment.

Salary is paid at least once a month and shall be paid in money exclusively, unless otherwise prescribed by the Law.

**MINIMUM SALARY**

An employee shall be entitled to a minimum salary for standard performance and full working hours. The minimum earnings are determined by the decision of the Social and Economic Council established for the territory of the Republic of Serbia. If the Social and Economic Council does not adopt a decision within 15 days from the start of negotiations, the Government shall decide on the amount of the minimum labor price within the next 15 days. In determining the minimum salary, the following will be especially taken into account: costs of living, subsistence and social needs of an employee and his/her family, rate of unemployment, employment trends in the labour market and the general level of economic development in the Republic. The minimum salary shall be determined per working hour and cannot be lower than the determined minimum earnings from the previous year, and are published in the "Official Herald of the Republic of Serbia". For 2017 the minimum salary was provided to be no less than approx. net Eur 1.08. (RSD 130.00) paid per hour, and increased for all contributions and taxes paid by the employer.

**REFUND OF EXPENSES**

An employee shall be entitled to a refund of expenses for traveling to and from work and for a business trip in the country and abroad, in the amount determined by a general act or contract of employment.

An employee is also entitled to a refund of expenses for: accommodation, nourishment and on-field operations, if the employer has not provided accommodation and nourishment; nourishment during work and compensation for the use of annual leave.

**SALARY COMPENSATION**

An employee is also entitled to a salary compensation during a justified absence from work for: a holiday which is a non-working day; annual vacation; paid leave; military drill; leave in case of a summons by governmental bodies; in case of sick leave; during interruption of work due to the Employer's fault etc.

**OTHER INCOMES**

An employer is liable to pay, in accordance with the general act: a retirement gratuity in the amount of no less than 2 average salaries, a refund of expenses for the funeral of the employee or his/her immediate family member, damages for the workplace injury or professional or profession related disease.

The employer may provide Christmas gifts for employees' children, voluntary pension insurance or disability insurance, jubilee reward, solidarity aid and other payments if determined by the general act, i.e. the Employment Agreement.

## • Social Security

The social security system in the Republic of Serbia is based on the mandatory public pension, health and unemployment insurance. The social security contributions are due by the income payer and income receiver in case of the payment of salaries, compensations to the management board members, persons performing temporary and periodical jobs and in other inapplicable cases. Social security contributions are due only by the income receiver in case of persons receiving agreed compensation (e.g. service providers under a service contract), shareholders of companies and in other inapplicable cases. The social security contributions are, in principle, always payable by the income payer. The only exceptions refer to situations where the income payer is not a legal entity or is a non-resident, not obliged to calculate and withhold social security contributions (international organisations, diplomatic missions etc.). In these cases, the income receiver is obliged to report the income and calculate and pay the social security contributions himself/herself, or pay based on an assessment of the Tax Authorities.

## • Health and safety

The most important rights arising out of state health insurance are: (i) health protection (this right encompasses almost all medical services: general practice, diagnostics, all kinds of therapy, medication, special practice examinations, surgeries, etc. whereby the insured person has to participate in the expense of the service, the amounts of which are usually rather symbolic) and (ii) salary compensation during sick leave longer than 30 days. During sick leave, the employee is entitled to receive compensation in the amount of 65% of its salary in case of work unrelated sickness or injury, whereby such compensation is covered by the employer for the first 30 days of the sick leave and thereafter by the State Health Fund; i.e. 100% in the case of a work related injury or sickness, whereby such compensation is covered by the employer from the first day of the sick leave and for the entire duration of sick leave.

Occupational hazards and the protection of employees' health and safety are regulated by the Health and Safety at Work Law ("Official Gazette of the Republic of Serbia" no. 101/2005 and 91/2015). The employer is obliged to secure the conditions of work and the work environment in which all measures related to safety and health at work have been taken.

If the employer has more than 10 employees, it must assign the work related to labour safety and health to one or more of its employees – having passed a relevant professional exam, or to engage a legal entity or an entrepreneur with a special license. The employer has to issue a written deed determining the responsible person for labour safety and health. The Ministry for Labour is in charge of the relevant professional exams and licensing.

The employer must receive a certificate on the fulfilment of all the conditions related to safety and health at the workplace before the commencement of its operations, and the employer has to inform the labour inspection at least 8 days in advance of its commencement of work and of any change in technology which affects the work conditions. A company must provide industrial safety training to employees during working hours.

Every employer also must provide a Workplace Risk Assessment Deed, which should include an explanation of the working processes, along with the assessment of possible risks at the workplace, measures for reduction and elimination of risk, and medical terms for special working conditions. The mode and procedure of risk assessment is to be regulated by a special regulation issued by the Minister.

The employer is obliged to insure its employees for workplace injuries, professional and work related diseases, in order to ensure the adequate compensation of damages. This type of insurance has not yet been regulated by a special law.

The employer is obliged to provide for the prevention and periodical check-ups of the equipment and the workplace by licensed entities. Work premises where toxic and hazardous substances are used in the industrial process must also be tested for chemical harmfulness (gases, vapours, etc.), physical harmfulness (noise, vibrations, etc.), lightness and biological harmfulness.

The employer is also obliged to provide for the prevention and periodical medical examinations of the employees.

## • Registries

Data on real properties is maintained in the publicly available Cadastral Registry. The Cadastral Registry contains both “technical” and “legal” data on immovable properties.

Ownership rights over land or buildings are generally obtained upon registration of the right in the relevant registry (the Cadastral Registry). Acquirers are deemed to be aware of all matters which are registered. In practice, it is considered acceptable to acquire a title from an unregistered owner and the registries will register such title, if there is sufficient evidence linking the acquirer with the currently registered owner as the previous transferor.

The ownership transfer document must be in written form, with signatures authenticated before the notary public. The document must contain explicit consent of the transferor that the acquirer may be registered as the owner (*clausula intabulandi*).

Apart from real estate in the narrow sense (land and buildings), the Cadastral Registry also contains a cadastre of grids, which is supposed to contain data on waterworks, sewage and drainage, heating, electro-energy, telecom, oil and gas grids, respectively. The cadastre of grids is not yet fully operational, since not all of the relevant data on the existing grids has been registered in it.

## • Buyer and seller liability

Commonly, the buyer has only one liability\obligation arising from real estate sale-purchase agreements – payment of the purchase price and payment of potential interests, if any. The seller is responsible for the material and legal defects of the property.

The seller is liable to the buyer in case there are any claims by third parties which may exclude, diminish or restrict the rights of the buyer acquired from the seller. If such claims arise, the seller is obliged to protect the seller. This means any assistance which would result in rejection of the claim or right of the third party. If not, the sale agreement is considered automatically terminated by law and the buyer is entitled to a compensation of damages. The seller's liability may be contractually restricted or excluded, except in cases when the seller was aware of the defect. The seller is liable for the material defects in case, for example, that the property is not fit for regular use, or the property is not fit for the special purpose of which the seller was aware, or the property does not have the characteristics explicitly or implicitly agreed by the parties.

This seller's liability may result in the automatic termination of the agreement, in case the seller failed to remedy the existing imperfections in the additional term provided by the buyer. The buyer is also authorised to require a compensation for damages.

In addition, according to the Serbian Law on Contracts and Torts, when a certain pool of assets is being transferred, together with the assets, the buyer also becomes jointly and severally liable alongside the seller for all liabilities in relation to that pool of assets, up to the value of the assets transferred.

## • Rights of foreigners to acquire real estate

A foreign entity can purchase construction land and buildings in the Republic of Serbia necessary for its business operations, subject to reciprocity, or, as the case may be, in accordance with the terms set out in a treaty between Serbia and the country of the foreign entity. Foreigners are explicitly banned from acquiring ownership of agricultural land.

If a foreign entity establishes a subsidiary in the Republic of Serbia, such a subsidiary is treated equally to any other local entity acquiring land and buildings, regardless of the origin of the founder or its controlling share. This means that foreign persons and entities may indirectly own real estate in the Republic of Serbia through their Serbian subsidiaries without any distinguishing limitations.

It can be expected that the regime of foreign ownership of real estate in Serbia will be further liberalised in the coming period. The Stabilization and Association Agreement between Serbia and the EU (the “SAA”), which entered into force in September 2013, prescribes that, within four years from the entry into force of the SAA, Serbia shall progressively adjust its legislation concerning the acquisition of real estate on its territory by nationals of EU Member States, to ensure the same treatment as compared to its own nationals.

## • Construction permits

### URBAN PLANNING

The issuance of building permits is conditional on the existence of a sufficiently detailed urban plan. Such plans are adopted by the relevant authorities for the state, regional or local level. In order to prevent the situation where the investor cannot obtain a building permit due to inaction of the state body which is supposed to adopt the required urban plan, it is under certain conditions possible to obtain the permit even without such urban plan, in accordance with the Planning Law.

The most notable recent developments in this area are that in 2016, when the City of Belgrade adopted a new General Urban Plan and the Plan of General Regulation. In addition, Belgrade also adopted detailed plans of regulation for certain parts of the city, with more such detailed plans on the way.

### BUILDING PERMITS

To commence construction works, the developer must obtain a construction permit from the relevant authorities.

In 2014, amendments to the Planning Law significantly changed the procedure of issuing building permits, simplifying it considerably. Now, most of the documents that an investor needs to obtain from the relevant authorities are issued in a uniform procedure, with the objective of enabling the investor a one-stop-shop in this process. Another important novelty is the introduction of an electronic system of application for the necessary building permits – even though the system is relatively new, it has come into life and building permits are now being issued electronically.



The introduction of the new system has had very positive effects in practice – during the period of March–December 2015, when the application of the new system started, the number of issued construction permits rose by a third compared to the same period in 2014. Further, 2015 saw a rise in the construction industry output of around 20%, which is significantly higher than the increase of Serbia's total GDP for that year (which was around 0.8%). This is a sign that the Serbian construction industry is in expansion and that the state is resolved to further foster this growth by cutting the red tape surrounding the issuance of building permits.

In general, in order to obtain a construction permit, the developer must have a proper title to the land on which he intends to build (the right of lease or the right of ownership). After the 28th of July, 2016, the right of use is no longer considered as the proper title for obtaining a construction permit – holders of such rights must first convert their rights of use to ownership (or enter a long-term lease) in order to obtain the necessary permits.

The competent authority needs to issue a construction permit within five working days from the date of application for such a permit. A construction permit ceases to be valid if, within two years as of its issuance, the investor does not commence construction works. As a rule, a construction permit also ceases to be valid in cases where the investor does not complete the construction and does not obtain a usage permit for the new structure within five years from the issuance of the construction permit. An additional two year extension may be granted if the investor shows that a minimum of 80% has been constructed and/or that the constructed building is in such state which allows the connection of the building to the external infrastructure network. If these deadlines are not observed, the investor is supposed to pay the property tax for the building in the entirety, as if the building was completed in accordance with the issued construction permit, until a new construction permit is issued for that location.

Once the building is completed, the competent technical commission is required to assess whether the building was completed in accordance with the technical designs, permits and consents. The technical commission is engaged by the investor. In case of a positive assessment by this commission, the investor can apply for a usage permit (necessary for the use of the constructed building). If the competent body does not decide on the request within five working days of the application, the constructed building can be used even without such a permit, provided that the assessment of the technical commission was positive.

Once the usage permit has been obtained, the authority which issued the permit ex officio registers the right of ownership in the Cadastral Registry.

## MORTGAGES

There is a duality of legal regimes for mortgages in the Republic of Serbia. The law differentiates between court enforceable mortgages and the, so called, out-of court enforceable mortgages. An out-of-court mortgage was introduced in 2005 by the Mortgage Law, and provides for a more efficient enforcement procedure than is the case with mortgages created in court procedures – based on mortgages enforceable out of court, claimants are authorised, under certain conditions, to independently sell the mortgaged properties, while the enforcement of mortgages created in court procedures involves a number of formalities.

Under the Mortgage Law, it is also possible to establish a mortgage over buildings undergoing construction. Such mortgages can be established and registered after obtaining a construction permit. This kind of mortgage is a security which is regularly used by the banks in financing construction projects. Once the structure is fully constructed and registered in the real estate registry, the registration of the mortgage over such constructed structures is performed simultaneously (unless the secured obligations are settled in the meantime and the mortgage is deleted). Mortgages are registered on the basis of relevant documents (e.g. mortgage agreement) which, among other things, have to contain a clear statement of the pledger allowing the establishment of a mortgage over certain property.

## EXPROPRIATION

A property may be expropriated or ownership restricted if required in the public interest, in accordance with the Law on Expropriation. The public interest for expropriation may be determined by the law or by a Government decree for specific development projects in the areas of: education, health care, social welfare, culture, water distribution, sports, traffic, energy and utility infrastructure, state, provincial and municipal institutions, defence, environment and disaster protection, mineral resources exploitation as well as public housing projects. In case of expropriation, market price compensation is payable to the person whose property is the subject of expropriation.

## RESTITUTION

In October 2011, the Republic of Serbia enacted the long expected Law on the Returning of Seized Property and Indemnification (the “Restitution Law”). The Restitution Law regulates the conditions, manner and procedures for returning of and the compensation for property that was taken from individuals and certain legal entities after the 9th of March, 1945, in the territory of the Republic of Serbia and then transferred to the national, state, social or cooperative property on the

basis of agrarian reform, nationalisation, sequestration and other regulations. The Restitution Law provisions apply to land, buildings and movable assets, as well as to companies that were seized in the past.

The in-kind restitution is set as the main principle. Where it is not possible, the state is to provide compensation through the issuance of government bonds. The maximum amount that one may receive as compensation is limited to EUR 500,000. Also, 10% of the compensation is payable in cash, once the decision on the returning of the property becomes final.

Nationalised property which was in private ownership at the time of entry into force of the Restitution Law is not subject of restitution in kind (only compensation from the state is available). This includes property acquired in the privatisation process.

The procedure for the return of seized property and indemnification is conducted before the Restitution Agency (as the first instance body) and the Ministry of Finance (as the second instance body where decisions of the Restitution Agency are challenged). In February 2012, the Restitution Agency announced a public call for the submission of requests for restitution. The submission of restitution requests was possible during a 2-year period, which ended in March 2014. Almost 600,000 requests were submitted in this time frame.



# ILP Abogados

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Spain

## General information

ILP Abogados is a law firm and, therefore, a business of its own. It is a business of professionals who provide legal services in which you can be completely confident. Firms around the world tend to build trust through: 1) their brand; 2) reference to various awards, ratios, recognitions, and rankings; income per associate or partner; number of lawyers; number of offices; number of countries; number of pro-bono hours; respect for diversity and gender; 3) invoking values such as commitment, rigor, dedication, quality, talent, and (for some) innovation.

ILP Abogados does not follow that pattern because we try to make everything easier. We are a firm built on long-term, professional re-

lationships. It is necessary both to earn the trust of our clients and for our clients to earn our trust. Our business and mutual trust creates a constant balance between both parties which permits understanding of the relationship between the client and the lawyer. The relationship will not function if we charge for more than we provide, or vice versa. For this reason, we have at your disposal a convenient table of professional fees that we apply equally to all clients.

### 📍 Head Office

Paseo de la Castellana 120  
5º Izq 28046 – Madrid

Plaça de Francesc Macià,  
5, 5º- 2ª 08021 Barcelona

Calle Reina Dña. Germana,  
nº 29 46005 Valencia

☎ +34 91 458 24 92  
☎ +34 93 159 88 31

[www.ilpabogados.com](http://www.ilpabogados.com)

## • Regulations and Rules

The legal framework of Corporate Law in Spain consists of:

In European Law, the main sources are:

- The Code of Commerce (1885) (Articles 116 to 150; 169 to 237)
- The Joint Stock Companies or Public Limited Companies (RD 1/2010 Ley de Sociedades de Capital, LSC)
- The Private Limited Companies (RD 1/2010 Ley de Sociedades de Capital, LSC) The Rules of Mercantile Register (RD 1784/1996)
- Private Equity Act 25/2005
- Bankruptcy Act 23/2003
- The Securities Exchange Act (24/1988)
- Law of Mercantile Adaptation to the European Community Standards (Act 19/1989)

## • Types of Companies and Liability of shareholders

Joint Stock Companies (Sociedades Anónimas), Private Limited Liability Companies (Sociedades de Responsabilidad Limitada), Collective Companies (Sociedades Colectivas), Partnership Companies - both simple and with registered shares (Sociedades Comanditarias Simples o por acciones) - and other associative forms have a diverse range of commercial uses. For setting up a business in Spain there are different legal forms. The forms most commonly adopted by foreign investors are:

- **Sociedad Anónima (S.A.) (Public Limited Company or Joint-Stock Company):** Corporation with a minimum capital stock of 60,000 euros of which at least 25% must have been paid at the time of incorporation, divided into freely transferable shares (similar to: UK: PLC; Germany: A.G.; France: S.A., Italy: SpA)
- **Sociedad de Responsabilidad Limitada (S.L.) (Private Limited Company or Company Limited by Shares):** Small sized corporations (a minimum capital of 3,000 euros, fully paid at the time of creation) which are subjected to lower reporting and auditing requirements than the S.A., and which may not issue stock (similar to UK: Ltd.; Germany: GMBH.; France: SARL., Italy: SRL)
- **Sucursal (Branch):** a division of a foreign company with separated accounting.

Other less common but valid legal forms are:

- **Empresario individual (Proprietorship):** an individual manages the business, providing the capital and assuming unlimited responsibility.
- **Comunidad de bienes (Co-ownership):** a business is not an independent legal entity and belongs to two or several proprietors who assume unlimited responsibility.
- **Sociedad Colectiva (General Partnership):** an independent legal entity which is owned by two or more general partners, all assuming unlimited responsibility.
- **Sociedad Profesional (Limited or Join Stock Companies):** their corporate purpose is to develop the exercise of professional activities.
- **Sociedad Comanditaria (Limited Partnership):** an independent legal entity which is owned by one or more general partners assuming unlimited responsibility and by one or more limited partners whose liability is limited to the amount of capital contributed.

The establishment of a branch - amended by the Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State - requires:

- A formal resolution of the foreign head office governing authorizing the establishment of a branch in Spain and appointing a representative.
- The resolution must be duly legalized to be valid in Spain, in order to constitute the branch with a Spanish Notary.
- Sell off the ITP tax (Impuesto de Transmisiones Patrimoniales y Actos Jurídicos Documentados); it is mandatory to lodge it, but there is an exemption for the incorporation and for the capital increase.
- Registration of the public deed in the Mercantile Registry in Spain (of its register office), including a copy of the head office's corporate bylaws duly stamped with an Apostille issued under the Hague Convention and a sworn translation into Spanish.
- Application for CIF (tax identification number) in the Tax Office's of the registered branch office with the articles of the association and the DNI or NIE of the representative agent in Spain.

## • Share Capital (minimum and minimum paid in amount)

Company	Minimum (€)	Minimum paid in amount (%)
PLC or Joint-Stock Company (SA)	60.000	25%
Company Limited by Shares (Limited Liability Companies) (SRL)	3.000	100%
Banks	18.000.000	100%
Insurance Companies	9.015.181,57	50%
Real Estate Investment Company	9.015.181,57	100%
TV Channels	6.010.121,84	50%
Chartered Stock Brokers	4.507.590,80	100%
Sociedades de Capital Riesgo (SCR) Venture Capital (Private Equity)	1.200.000	50%
Sociedades Gestoras de Fondos de Capital Riesgo (Venture Capital Fund Management) (Private Equity Management)	300.000	100%
Private Equity Funds	1.650.000,00	100%
Private Equity Companies	1.200.000,00	50%
Hedge Funds	3.000.000,00	100%

## • Classes of shares (registered/bearer, preferred/ordinary) Registered/Bearer

Bearer shares are corporate stock certificates which are owned simply by the person who holds them, the “Bearer”. These shares are not registered on the books of the issuing corporation and are transferred by delivery. These shares are only allowed when capital stock has been fully paid up.

Registered Shares are those which are registered on the books of the issuing corporation (Libro Registro de Acciones Nominativas) and certificates the name of the owner. Common (ordinarias o comunes) Stock and Preferred (privilegiadas o preferentes) Stock. The shares can grant different rights. The shares that have the same content of rights constitute the same class. When inside a class several series are constituted, those that integrate a series must equal nominal value.

The preferred stocks grant some privilege out of the ordinary ones, there will be necessary to observe the formalities prescribed for the modification of By-laws. If there is only one class of shares issued, they may be called “common shares”, “capital shares”, or just “shares” or “stock”.



## • Common Stock

They represent ownerships in a corporation. Holders of common stock exercise control by of the society electing a board of directors and voting on corporate policy.

## • Preferred Stock

These shares bestow certain rights and privileges not accruing to common stock. These rights or privileges shall be financial (mainly concerning dividends); but never political, such as “the right of vote” or “the preferred subscription right”.

After the incorporation, the issuance of Preferred Stock is an amendment to the By-Laws.

## • Corporate Governance: Classes

### SHAREHOLDERS MEETINGS

Decisions reserved to the Shareholders (160 LSC):

- Approval of financial statements and distribution of profits and Approval/Censure of Management (Art. 160).
- Appointing and Removal of Directors (Art. 209- 252), Auditors (Art.264), Liquidators (Art. 376-382).
- Changing the By-Laws: (Art. 285-345)
- Winding-Up or Dissolution (Art. 360-370)
- Approval of the liquidating balance sheet
- Approval legal merger, spin-off, disposals of existing fixed assets
- Approval legal merger, spin-off, disposals of existing fixed assets
- Other matters determined by the By-Laws or the LSC

The board members must meet minimum once a year (Annual General Meeting -AGM) in order to approve the financial statements, distribution of profits and Approval/Censure of Management.

## • Decision-making bodies

### CLASSES AND POWER OF DIRECTORS

- Sole Director (Administrador Único)
- Sole and several Directors (Administradores Solidarios)
- Joint and several Directors (Administradores Mancomunados)
- Board of Directors (Consejo de Administración)

### APPOINTMENT OF DIRECTORS

- Directors shall be appointed by the Shareholders Meeting (Art 214 LSC and Art. 142 Rules of Mercantile Register).
- When the administrative body is constituted by a board of directors, this one shall be formed by a minimum of three directors and in the SRL (Private Limited Liability Companies) shall not be more than twelve members.

### MINIMUM NUMBER OF INDEPENDENT DIRECTORS

There is no binding rule. Nevertheless, “The Olivenzia Report” and “The Aldama Report” - two Codes of Best Practice - provide some recommendations concerning this question.

### TERM OF APPOINTMENT

- For Joint-Stock Companies (SA). The term of appointment shall never be longer than 6 years (Art. 221.2 LSC and and 145 Rules of Mercantile Register)
- For Companies Limited by Shares (SL). Directors may be appointed for an undetermined period of time (Art. 221.1 LSRL)

## RANGE OF DIRECTORS' LIABILITIES

- **Does Law require a specific agreement - or disclosure - for determining the remuneration of Directors?**
  - On the Joint stock companies, the scope of Directors' duties shall be determined by the By-Laws. On the limited liability companies, the Directors' duties are generally not remunerated, unless the By-Laws establish a remuneration and the method of calculation. Remuneration is often in the form of a percentage of after-tax profit
  - **Any limit?**
- (SA)** The Directors' remuneration is set only after allocating the legal and statutory reserve and at least the 4% - or other higher percentage determined in the Estatutes – of dividends in favour of shareholders
- (SRL)** The aggregate number of Directors' remuneration must not exceed 10% of the after tax profit

## LIABILITIES

(SA and SRL) Directors' liabilities, contribution to damages caused in the course of their duties and the procedure of claiming against them, are set in detail in Articles 236–241; 25LSC

## ANNUAL ACCOUNTS-FINANCIAL AND OPERATING RESULTS: DUTIES AND LIABILITIES

Necessary Documents: 1) Profit and Loss Account; 2) Balance Sheet; 3) cash flow statement; 4) Statement of Changes in equity; 5) Memory; 6) Management Report; 7) Auditors Report; and 8) the certification of the AGM Minutes in which the approval of Annual Accounts took place.

## • Time Limit for delivery of documents

### **DIRECTORS WILL DRAFT THE ANNUAL ACCOUNTS**

(Cuentas Anuales) no later than 3 months after the end of the corporate year (December, 31). The AGM will examine and approve or refuse these Annual Accounts no later than 6 months after the end of the corporate year. Time Limit for deposit/application/registration: No later than 30 days after the AGM approves the Annual Accounts.

### **AUTHENTICATION**

Secretary and Chairman's signature in the certification of AGM Minutes in which the approval of Annual Accounts shall be authenticated by a Public Notary.

### **PUBLICATION IN A LEGAL GAZETTE/MERCANTILE REGISTER**

The Legal Gazette ("Boletín Oficial del Registro Mercantil") shall publish a report on the fulfilment of corporate duties, and a notice that the Annual Accounts are publicly available in full. By-Laws are also publicly available in Mercantile Register.

### **PRIVATE EQUITY COMPANIES**

The Private Equity Act (November 2005) regulates the so-called "Venture Capital Entities" and their Management Entities. A Venture Capital Company is legally qualified as a Financial Entity with the purpose of investing in: (i) Non-Financial Business, or (ii) Business that are not dedicated to non-listed Real Estate businesses.

These Entities may acquire listed companies within the term of 12 months of acquisition; squeeze-out measures have not been approved yet, to facilitate taking 100% of shares.

## **BANKRUPTCY**

The reform of the Spanish Insolvency Act (Ley Concursal) carried out in September 2003 was a very relevant change because it finished off a legal system which had finally become obsolete. The modification of credit categories and its preferences was one of the most important elements of this reform.

## **QUOTED COMPANIES**

### ► **Regulation**

*Ley de Sociedades de Capital (Arts. 495-528)*  
*Ley 24/1988, de 28 de julio, del Mercado de Valores.*

“The Olivencia Report” and “The Aldama Report” – two Codes of Best Practice – provide some recommendations concerning Quoted Companies. However, there is a new –January 2006 – specific Best Practice Blueprint for quoted Companies, known as “The Conthe Report” and properly named “Unique Code for Best Practice Corporate Governance of Quoted Companies”. This Code includes the European Commission Recommendations (2005/162/EC) and (2004/913/EC).

## • Corporate income Tax

### **TAX RATE**

The prevailing general rate is 25% from January 2016.

### **CORPORATE RESIDENCE**

Any company, which is considered as resident, that generates incomes in the Spanish territory is subjected to corporate income tax, through a subsidiary, branch office.

Permanent establishments opened in Spain: non-resident's tax at a 25% rate on their tax profit from 2016.

### **BRANCH INCOME**

The incomes generated by a branch in a foreign territory, will be part of the incomes of the head office. Nevertheless, any income obtained in Spain through a branch of a foreign entity, will be taxable at general rate, applying the general rules for Spanish entities.

Incomes remitted from the Spanish branch to the head office are subject to a 19% withholding tax. Exemption is applied to EU head offices and to those territories that signed double taxation treaties with Spain.

## INCOME DETERMINATION

If the law does not say anything on the contrary (transfer pricing new policies are highly relevant in this particular area), the Spanish Accounting Rules (Plan General de Contabilidad Español - PGCE) will be applied to the income determination. If the law is applied in a different direction, two kinds of differences between the P&L financial and taxable will be generated:

- **Temporal differences:** They generate advance or deferred corporate tax, their appearance is conditioned to the specific moment of the deductibility of the costs
- **Permanent differences:** It includes the non deductible costs, such as: capital retribution, corporate tax, penalties and sanctions supported from the Tax Administration, liberalities (with the exception of PR costs with clients or suppliers, sales promotion costs, moderate costs to employees, between others).

## TAX INCENTIVES

The main tax incentives (to be done on the next tax due) are the following:

Deducción por actividades de I+D (art. 35.1 LIS)	8 / 42%
Deducción por actividades de innovación tecnológica (art. 35.2 LIS)	12%
Deducción por inversiones en producciones cinematográficas españolas (siempre que cumplan los requisitos del art. 36.1 LIS)	18/20%
Deducción por producciones cinematográficas extranjeras en España (siempre que cumplan los requisitos del art. 36.2 LIS)	15%
Deducción por producción de determinados espectáculos en vivo (siempre que cumplan los requisitos del art. 36.3 LIS)	20%
Deducción por creación de empleo (siempre que cumplan los requisitos del art. 37 LIS)	3.000€ / 50%
Deducción por creación de empleo para discapacitados (art. 38 LIS)	9.000€ / 12.000€

## GROUP TAXATION (TAX CONSOLIDATION)

It is permitted for corporate tax effects, and the withholding on account of this tax. The decision must be taken and notified to the Tax Authorities at the beginning of the fiscal year. At this moment, the consolidated corporation should have more than the 75% of the capital of the Spanish entity, directly or indirectly.

## • Special tax regimes

### CANARY ISLAND ZONE (ZEC)

All the companies incorporated between June 2000 and December 31, 2020 can apply to this special regime, and receive the tax benefits until December 31, 2026. The registration requires: (1) a minimum investment of 100.000 (Gran Canaria y Tenerife) in the first two years of activity, (2) to create at least 5 new jobs in Gran Canaria or Tenerife or 3 in the other islands. The corporate tax is 4%, and limited to specific taxable base amount. The general rate will be applied over this base. There are exemptions regarding IGIC and transfer tax. The EU Parent-Subsidiary Directive are applied for non EU countries, with the exceptions of tax haven.

### ETVE COMPANIES (SPANISH HOLDINGS OF FOREIGN ENTITIES)

Main features of the ETVE: (a) Their corporate purpose must primarily be the management and administration of shares in entities that are not resident in Spain. (b) They must have the corresponding organization of human and material resources. (c) The shares (or participations) held by the ETVE must be all nominative. (d) Incompatible with the regime of fiscal transparency. (e) It is required to communicate to the Ministry of Economical Affairs about the regime going to be used:

**Dividends resulting from benefits obtained by entities not resident in Spanish territory are exempt of Corporation Tax upon fulfillment of the following conditions:**

- The investment is at least 5 % or the acquisition value exceeds 20 million euros, and is maintained continuously during the fiscal year prior to the day when the dividends or shares become due.
- The entity that is not resident in Spanish territory must be subjected to and not exempt of a tax that has an identical or similar nature as the Spanish Corporate Tax.
- The income of the entity not resident in Spanish territory from which the dividends have been obtained must carry out business activities abroad, this condition is complied with in the event that at least 85 % of the income of the accounting period corresponds to:

**Capital gains resulting from transfer of shares in entities not resident in Spanish territory, upon fulfillment in all the cases of the following requirements, are exempt**

- Those indicated in point a) above (referred to all the accounting periods during which the stake was held, except the first one, referred only to the day of the transfer).
- That the acquirer is not resident in a Tax haven.
- This regime is also applied to the rent resulting from the events of separation of a shareholder or liquidation of an entity.



The most important difference with the general tax system is the treatment of the dividends paid by the Spanish Holding to its non-resident shareholders or the capital gains obtained by the non-resident shareholders in the case of transmission of the shares of the Spanish Holding.

In this case a distinction must be made between the perception of dividends and the obtaining of capital resulting from the transfer of shares in the Spanish Holding (or in the events of separation or liquidation of the entity).

- **Dividends:** The distributed benefit, when it results from income not integrated in the taxable base because of its exemption, it is considered not obtained in Spain and consequently not subjected to taxation in Spain.

Capital gains resulting from transfer of shares: The capital gains corresponding to either the provisions to cover exempt rent or to the differences in value imputable to shares in entities not resident in Spanish territory are considered gained out of Spain and are consequently not taxed in Spain.

#### **VENTURE CAPITAL COMPANIES AND FUNDS AND COLLECTIVE INVESTMENT INSTITUTIONS.**

The venture capital companies, regulated under Law 22/2014 will be exempted in a 99% of the revenues generated by shares transmission of related companies, if the investment has been in their assets at least 1 year and no more than 15.

During the investment of the venture capital in the related company, at least the 85% of the buildings of the related company must have been used for the main activity of the company. The exemption is available for dividends received from related companies, no matter how long the shares have been in the venture capital assets.

#### **THERE ARE OTHER SPECIAL TAX REGIMES SUCH US**

- Temporary consortia of companies.
- Restructuring transactions.
- Fiscal transparency (international-controlled foreign corporation rules)
- Special tax regime of the Basque country

#### **DOUBLE TAXATION DEDUCTION**

According to the Spanish regulations, a Spanish entity should be taxable in all the incomes perceived, even when some of them were generated abroad. Nevertheless, the Corporate Tax law considers a special deduction to avoid some activities are taxable in two territories, or in other entity.

**Internal double taxation deduction:** It is focused in the double taxation over a single income for two different entities (generally dividends).

**International double taxation deduction:** There is a juridical double taxation, system which is applied to the same income taxed in two countries (withholding tax at source), and an economic double taxation, the same income taxed in two companies and/or in two different territories.

**The dividends or profit-sharing income from a foreign entity are exempt in Spain if:**

- The Spanish entity has at least 5% or the acquisition value exceeds 20 million euros, of the shares of the foreign entity, during the last fiscal year
- The foreign entity is subjected to a similar tax to the Spanish corporate tax, and it is not a tax haven country. When a double taxation treaty is signed between that country and Spain with exchange of information clause, this clause is presumed
- The income of the dividend was generated in foreign activities of the foreign entity carried out abroad

About the double taxation, the imputation method is used, it means, gross foreign income (including the withholding tax already paid) is considered for Spanish tax calculation purposes, and then a tax credit for the foreign withholding tax is applied, limited to the corporate tax that would be paid if such gross income (with the deduction of all associated costs), had been obtained in Spain.

## • Tax administration

### RETURNS

If there is a tax credit, a return can be applied.

### PAYMENT OF TAX

The last day of payment is 25 th of July. After the first year of activity, three advanced payment are required (Oct. 20 th , Dec 20 th , Apr 20 th ). The advance payment may be calculated according to the company size:

- **Large entities:** 25% of the profit at Sep30th, Nov 30 th and March 30 th .
- **Small entities:** Can decide at the beginning of the fiscal year between the large entities system, or applying the 18% to the corporate tax paid the year before.

## WITHHOLDING TAXES

Country	Dividends <sup>1</sup>	Interests	Royalties <sup>2</sup>
Algeria	5	5	7 - 14
Arab Emirates	5	0	0
Argentina	10	12,5	3 - 15
Australia	15	10	10
Austria	10	5	5
Belgium	15	10	5
Bolivia	10	15	15
Brazil	10	15	15
Bulgaria	5	0	0
Canada	15	15	10
Chile	5 - 10	5 - 15	5- 10
China P.R.	10	10	10
Croatia	15	8	8
Cuba	5-15	10	5
Czech Rep.	5-15	0	5
Denmark	5-10	10	6
Ecuador	15	10	10
Egypt	12	10	12
Estonia	5-15	10	5-10
Finland	10-15	10	5
France	15	10	5
Germany	10-15	10	5
Greece	5-10	8	6
Hungary	5-15	0	0
Iceland	5-15	5	5
India	15	15	10-20
Indonesia	10-15	10	10
Iran	5-10	7,5	5
Ireland	15	0	5-10
Israel	10	10	5-7
Italy	15	12	4-8
Japan	10-15	10	10
Korea	10-15	10	10

<sup>1</sup> Note that as Spain has implemented in its legal regulation the EU Parent/Subsidiary Directive, the dividends perceived from an EU subsidiary may be exempt of the withholding tax (under specific premises). For Luxembourg does not apply to entities under the paragraph one of the protocol to the tax treaty between Spain and Luxembourg.

<sup>2</sup> The percentage can vary depending of the specific intellectual property which generates the royalty.

Latvia	5	10	5-10
Lithuania	5-15	10	5-10
Luxembourg	5-15/10-15	10	10
Macedonian	5-15	5	5
Malta	5	0	0
Mexico	5-15	10-15	10
Morocco	10-15	10	5-10
The Netherlands	15	10	6
New Zealand	15	10	10
Norway	10-15	10	15
Philippines	10-15	10-15	10-15-20
Poland	5-15	0	10
Portugal	10-15	15	5
Romania	10-15	10	10
Russian Federation	5-15	5	5
Slovakia	5-15	0	5
Slovenia	5-15	5	5
Sweden	10-15	15	10
Switzerland	10-15	10	5
Thailand	10	10-15	5-8
Tunisia	5-15	5-10	10
Turkey	5-15/5-25	10-15	10
United Kingdom	10-15	12	10
United States	10	10	10
USSR	10-15	42278	10
Venezuela	10	10	5
Vietnam	7	10	5
<b>Non teatry</b>	<b>15</b>	<b>15</b>	<b>25</b>

## • Other taxes

### VAT

VAT is levied in good supplies and services given and provided inside Spain, import/intra EU acquisitions of goods. There are three different rates: general at 21%, reduced at 10% and super-reduced at 4%. In Canary Islands, VAT does not apply, but the IGIC (Impuesto General Indirecto Canario) with an ordinary rate of 7%.

**TRANSFER TAX (TT)**

It is used in “inter vivos” transfers when there is no VAT. The rate can vary, depending on the Autonomous Region.

**STAMP DUTY**

Notarial documents of valuable transactions (fix rate: 0,15 per sheet, variable rate:0,5). Other documents submitted to the Public Administration, administrative documents and mercantile documents (such as a bill of exchanges), have a scale. Compatibilities between the three taxes and the VAT:

<b>Compatibilities between them</b>	Compatibility	Incompatibility
TT versus CT	-	X
TT vs SD (variable)	-	X
TT vs SD (fix)	X	-
CT vs SD (variable)	-	X
CT vs SD (fix)	X	-

  

<b>Compatibilities with VAT</b>	Compatibility	Incompatibility
Transfer tax	-	X
Capital Tax	-	X
SD (Variable)	-	X
SD (Fix)	X	-

# Spain | FOREIGN INVESTMENT

In the context of implementation of the European Union Maastricht Treaty, Spain made significant revisions to its legislation on foreign investment. Royal Decree 664/1999 has set up as a general rule complete freedom of capital movements, both in relation to foreign investments in Spain as well as to Spanish investments in other countries. However, this general regime does not apply to certain specific sector legislation such as the defense sector. These exceptions to the general regime of complete freedom of capital movements are only allowed on the basis of public order and security, public health, and the exercise of sovereign authority. Foreign investments:

- Participation in Spanish companies
- Establish and increase capital allocated to branches
- Subscription for and acquisition of marketable debt securities issued by residents
- Participation in mutual funds recorded in the Registers of the Spanish National Securities Market Commission (CNMV)
- Acquisition by non residents of real estate located in Spain valued at more than 3.005.060,52 € (or regardless the value if the investment is originated in a tax haven defined in Royal Decree 1080/1991 of 5 July).
- Formation or participation in joint ventures, foundations, economic interest groupings, and cooperatives if the total value of the investment exceeds 3.005.060,52 € (or regardless the value if the investment is originated in a tax haven defined in Royal Decree 1080/1991 of 5 July).

## GOVERNMENTAL DECLARATIONS (OF CAPITAL), AUTHORIZATIONS AND PERMITS.

Order of 28th May 2001 puts into effect the guidelines from the Royal Decree 664/1999. It establishes the necessary procedures to declare foreign investments and its liquidation, as well as procedures for obtaining authorizations and annual reports. Direct foreign investments are subjected to a notification after the investment has been made. The form and the deadline of the declaration are determined by the 1st July 2010 Resolution.

Foreign investments in Spain, as well as their liquidation, must be declared to the Register of Ministry of Industry, Tourism and Trade, for administrative, statistic or economic purposes. These documents can be downloaded at <http://subsede.comercio.mityc.gob.es> ≥ Proceeds and Electronic Services ≥ Download assistance programs.

Typically, non-resident investors are required to report the investment once it has been made. The general regulation may be suspended in exceptional cases by decision of the Council of Ministers, so a prior authorization is required in the certain circumstances:

- When the declaration concerns an investment coming from a tax haven jurisdiction, the declaration must be made by the investor prior to the actual investment. This declaration is in addition to the declaration to be made subsequent to the actual investment.

**No prior declaration is required in the following cases**

- Investments in negotiable instruments, as well as participations in investment funds registered in the records of the "Comisión Nacional del Mercado de Valores (CNMV)" (Securities and Investments Board).
- Where the foreign participation does not exceed 50% of the capital of the Spanish company target of the investment.

Prior declarations of investments are made by the investor on the preprinted applications DP- 1 (Previous declaration of foreign investment coming from tax havens in non listed companies, branches and other type of investment) or DP-2 (Previous declaration of foreign investment coming from tax havens in real assets). No documents are annexed to these applications.

Foreign investments in Spain in activities directly related to national security, such as those intended for the production or sale of weapons. Except when the foreign investment does not exceed 5% of the share capital of the Spanish company and it is not allowed to be a member of the management board of the company, directly or indirectly.

Foreign investments in Spain that affect or might affect activities related to the enforcement of the public order or which affect or might affect public security and health.

Direct or indirect investments in Spain by non EU member states for the acquisition of property intended to be used as diplomatic and consular offices.

The prior declaration of investment is valid for six months, from its filing, so that, when the investment not materialize in that time, a new prior declaration is required. It should be pointed out that once the prior declaration has been made investors can make their investment without having to wait for prior notification from the government, even though they are still subjected to the notification after the investment has been made.

**Order of 28th May 2001 establishes that the actual investment shall comply with the following rules:**

- Declarations related to investment operations in privately held companies, branches, real assets and other type of investment.

The declaration (application D1-A for the declaration of foreign investment in privately held companies, branches and other types of investment) shall be addressed to the Investment Registry of the Ministry of Economy within a maximum period of one month from the actual investment, supporting documents shall be attached to the said declaration to evidence the following:

- Non resident status of the investor.
- Where applicable, compliance with any requirement of sector legislation.
- Having obtained an authorisation in the hypothetical cases of a suspension of the liberalization regime.

**Having made a prior declaration, if required.**

- For investments in real assets, a concise explicative report which states the main features of the investment.
- Declarations related to investments in real assets. The declaration shall be submitted to the Investments Registry through the printed application D- 2A (Declaration of foreign investment in real assets) within one month from the actual investment.
- Declarations related to investments in negotiable instruments. Non residents who subscribe to or purchase negotiable instruments in the Spanish market, on their own account or that of third parties, shall maintain their securities and assets in a registered account opened with an authorized market compensation and liquidation institution.

The depositary or administrator for the assets represented by account entries, shall submit to the “Dirección General de Comercio e Inversiones” (General Direction of Trade and Investments) about a report on flows in the ordinary or extraordinary market operations for non residents, subscriptions to share capital made directly with the issuing company or through the Bank, registrations and discharges of non resident deposits related to security transactions other than sales and purchases thereof.



These reports are rendered on a monthly basis between day 1 and 20 of each month for transactions during the previous month.

Likewise, the deposits and balances in accounts of non residents on the Entries Central of the depository, as at 31 December must be declared during the month of January

### **TRANSFER OF DIVIDENDS, INTERESTS AND ROYALTIES**

The acts, businesses, transactions and operations of any kind which suppose, or require, charges or payments between residents and non residents, or transfers to or from abroad, on a general basis, are free.

However, as an exception to this general rule, the Ministry of Economy, may forbid or limit certain categories of transactions with specified foreign countries or specified operations of charging, payment or transfer, whenever these dramatically affect the interests of Spain, or in application of measures adopted by international bodies of which Spain is a member.

Likewise, whenever short term capital movements are exceptionally ample and may cause significant tension in the foreign exchange market or dramatic alterations in the direction of the economic and foreign exchange policy, the Government, at the request of the Ministry of Economy, is able to adopt safeguard measures as necessary, submitting certain types of transactions to a regime of administrative authorisation.

The charges and payments between residents and non residents, as well as the transfers to or from outside of Spain, may be coded in euros or in foreign currency, and must be made through a Deposit Entity inscribed in the “Registros Oficiales del Banco de España” (Official Registrar of the Bank of Spain, “Registered Entities” hereinafter).

In any case, the resident shall declare to the “Registered Entity”, his name or company name, domicile, tax identification code, name or company name and domicile of the non resident sender or beneficiary of the charge or payment, amount, currency, country of origin or destiny, and concept of the operation by which the charge, payment or transfer takes place. The “Registered Entities”, in their case, shall provide, in the manner determined by the Ministry of Economy and within thirty days after each calendar month, such information.

The “Registered Entities”, as well as the resident natural or corporate persons who carry out this type of operations, shall be subjected to the obligation of providing the competent bodies of the Government Administration and the Bank of Spain, in the manner established, the data required for the purposes of statistic and fiscal follow-up of the operations.

#### **REPATRIATION OF CAPITAL. PROCEDURE OF LIQUIDATION OF INVESTMENTS IN PRIVATELY HELD COMPANIES, BRANCHES, REAL ASSETS AND OTHER TYPES OF INVESTMENT.**

For the total or partial liquidation of such investments, the holder of the same, commissioner for oaths or other person obliged to declare, as the case may be, shall submit the declaration of liquidation in the printed application D- IB (Declaration of liquidation of foreign investment in non listed companies, branches and other types of investment) duly filled in and subscribed. Each holder shall fill in a single application for each liquidation referred to even if there are several documents of declarations of investment in one same Spanish company.

#### **PROCEDURE OF LIQUIDATION OF INVESTMENTS IN REAL ASSETS**

For the total or partial liquidation of a foreign investment in real assets, the holder or the commissioner for oaths shall submit the declaration of liquidation in the application D-2B (Declaration of liquidation of foreign investment in real assets) duly filled in and subscribed by the non resident holder.

In case of partial disinvestments, either for the change of one or several of the holders of a property “pro indiviso”, either for the transmission of a part of the real assets declared in one same instrument of declaration, such partial disinvestment shall be declared to the Registry of Investments.

In the event of the exchange of securities in a privately held company for negotiable instruments of another company, the printed application D-1B (Declaration of liquidation of foreign investment in privately held companies, branches and other types of investment) of the investment liquidation, through the intervention of the company or Securities Brokers or the member of a secondary market, official or not, of values which are part of the operation, along with the Significant Participations Communication, if deemed suitable, shall be submitted. The values acquired through the exchange shall be included as the “purchase flow” in the mandatory report by the depositary or administrator.

In those cases where the exchange of negotiable instruments for values of other privately held companies takes place, the relevant Significant Participations Communication for the securities delivered in exchange shall be submitted, if suitable, along with the printed application D-1A (Declaration of foreign investment in non listed companies, branches and other types of investment) of foreign investment declaration in non negotiable instruments, with the intervention of the entity which orchestrated the transaction, shall be submitted. The values delivered in exchange shall be included as the “purchase flow” in the mandatory report by the depositary or administrator.

## ANNUAL REPORT

Spanish companies participated by non-resident must file an Annual Report on investments to the Administration in the following cases:

- Branches in Spain, in all cases
- Spanish companies with capital or shareholder’s equity of over 3.005.060,52 euro and in which 50% or more of the equity capital is held by non-resident investors.
- Spanish companies with capital or shareholder’s equity of over 3.005.060,52 euro and in which a single non-resident investor holds 10% or more of the company’s equity capital or of the total voting rights.
- Spanish companies that belong to a company group or in which 50% or more of the equity capital is held by a non-resident investor or in which a single non-resident investor holds 10% or more of the company’s equity capital or of the total voting rights. In such cases, neither the capital nor the shareholder’s equity is taken into account.

The report must be presented within 9 months from closing the accounting period. For this procedure the application D4 must be completed, and a copy of the Business Tax or the annual accounts must be attached to it.

**FOREIGN PERSONNEL; PERMITS AND OTHER ASPECTS TO BE CONSIDERED**

Prior work permits are required for all foreign citizens over sixteen years of age who wish to carry out in Spain any lucrative, work-related or professional activity, on their own behalf or that of others.

This regime shall not be applied to the nationals of the member States of the European Union, to the nationals of Third States to whom, by reason of relationship, the communitarian regime can be applied, except the nationals of the new States (save for Cyprus and Malta) that joined the European Union on 1 st May 2004, for the application of a transitory period of two years from that date. Work permits will only be delivered to new immigrants only if in Spain it is not possible to find adequate workers with the skills needed in order to perform the work as determined by the State agency which handles job offers.

The application for work and residency permits must be presented personally by the prospective immigrant to the appropriate State agency. In the event that the applicant is also an employer, the application must be submitted by the applicant or a legal representative of the employer. Where the applicant resides outside of Spain, the application may be submitted before the Diplomatic Mission or Consular Office in the district where he may live.

The application will be processed in the following manner: Upon completion of a review of the application, the relevant authority (Government Vice Delegate or Government Delegate in the autonomous communities made out of one sole region) shall deliver a unique resolution by which the foreign citizen is authorised to work and live in Spain, the beginning of his work activity and carry out his membership of, registration in and quotation to the “Seguridad Social” (Social Service). The resolution shall be notified to the businessman, indicating the amounts that need to be satisfied in concept of taxes, expiring if after a month from the date of such notice the corresponding visa was not, in its case, requested.

Once the application has been submitted to an Embassy or Spanish Consular Office, the resolution shall be notified to the interested party by the mentioned instance, through the Ministry of Foreign Affairs. The resolution and notice shall be carried out within a three-month period, counting from the day after that one of the date in which the entry of the application in the registry of the competent body to handle it has taken place. After that period has expired, the initial work permit applications shall be understood as dismissed.

# Spain | LABOUR LAW

- **Prior Warning**

In Spain the Labor Jurisdiction is quite protective for workers. It's difficult to obtain a favorable ruling defending investor's rights against the worker. Likewise, there are no court costs before the Labor Jurisdiction, so suing the employer is easy in Spain because no legal costs are incurred if the worker is defeated by the Company.

- **Contracts**

It is generally possible to form verbal contracts, when the employee is over 18 (except for freelance workers).

- **Types of Contracts**

Contracting under Labor law in Spain is a broad subject, but can be summarized as follows:

- **Permanent Contracts:** unlimited in time. When we use this modality for hiring people with some specific conditions, we can benefit from reductions in Business Social Security contributions, if the firm is up to date with its tax and social security payments and has not been sanctioned for infringements. Those special workers are those aged under 30 years or over than 45 years, long-term unemployed (over 2 years), handicapped unemployed for more than 3 months, and unemployed women.
- **Part-Time Contracts:** This is not strictly speaking a different type of contract, but rather a form of dividing the working day. There must be always a written contract and is divided into two forms: part-time and relief work. All contracts can be full-time or part-time (except for training). The part-time mode denominated 'relief' is used to hire a worker to progressively substitute a worker who is going to retire.

## • Contracts of defined duration (Temporary):

- **For work:** it is used for a particular work or service, always with an uncertain duration, but always subordinated to the work or service to be performed. Maximum duration limited to 3 years.
- **Temporary:** Serves to substitute a worker until his/her reincorporation, e.g. Forced Absence (exercise of Public Positions); must be written.
- **Casual:** it is used to attend to market conditions (circumstances and production) resulting from the accumulation of orders and/or an excess of tasks. Cannot exceed 6 months within a period of 24 months (Otherwise the contract must be made permanent). The contract must be in writing if the period is longer than 4 weeks.

The transformation of these contracts (Works, Temporary and Casual) to permanent contracts once that maximum duration has been completed operates automatically. In case the contract stops fulfilling all the requirements for a modality (Works, Temporary and Casual), the contract can be renamed as a permanent contract, and the worker can ask the employer or the Public Entity in charge for a document to prove his/her new status.

## • Training Contracts

It consists on providing the worker with knowledge and techniques to develop his/her work, there are two types:

- **Training:** once the student has finished his education, he/she participates in a business as an intern, and the employer must provide a certificate of the training received at the end of the period. It shall last minimum 6 months, and maximum 2 years. The number of these contacts in the firm is limited depending on its size. The salary cannot be under the minimum inter-professional, and must be between the 60 and 75% of the official salary according to the applicable Collective Convention.
- **Apprenticeship:** This is for workers to obtain diplomas, degrees and equivalents. For professions where no higher education is required. The age of the worker must be necessary between 16 and 21 years old, in case of unemployed it may be rise to 24, and not to be in possession of the qualification required for the post. It may last minimum 6 months and maximum 3 years. It can be part-time, but the program must necessary include at least a 15% of lessons. Convention.

## • Other special contracts

- Group work is for a group of workers having a link with the firm and a group leader; not necessarily written.
- Working from home, without supervision by the firm, written
- Substitution, to cover anticipated premature retirements, in written.

## • Contracts for the handicapped

If the contract is Permanent, a 33% of disability is required and must be accredited with a certification, and the worker cannot be related to the employer more closely than the second degree. The contract must remain in force for at least three years, and in the case of a justified termination, there is an obligation of hiring for the remaining period. These contracts give access to an automatic subvention for the firm and a bonus of four monthly social security quotas.

If the contract is Temporary, it must be for at least 12 months and not more than 3 years. The rest of requirements of this modality are the same as for the permanent contract. It includes a bonus of social security quotas, and its conversion to a permanent contract generates a subvention. It can be offered for Training; the training in this case has no age limit and the firm is not limited in the number of contracts it can offer. Bonuses are paid in social security. If the contract is for Apprenticeship, the handicapped person must provide the disability certificate, as well as the education certificates. The apprenticeship period may start up to 6 years from completing the studies.

## • Contracting Administrative and Top Management Staff

The Authorised Employers and/or Top Manager of the business must be distinguished from the ordinary labor relation. If the employer chooses to be self-employed, he/she is inscribed in the self-employed regime and with regard to Social Security, works for him/herself. However, in the case of a limited or non-limited company, non-labour, he/she can work either as self-employed or as employed because the regime will vary depending on his/her functions and participation as capital partner of the company.

- If a partner performs management or advisory functions, or personally offers other services, and also possesses effective control of the company, either directly or indirectly, he/she should register in the self-employed regime (SELF-EMPLOYED). It is understood that effective control of the company in terms of participation is possessed when: The related parents to the second degree or less constitute more than or equal to 50%; his/her share alone is equal to or more than 33%; or he/she is the managing director of the company in possession of at least a 25% shares.
- In any other case, the inscription is made in the Social Security Offices: NORMAL REGIME for executives or persons in charge, and PROFESSIONAL REGIME for top managers with certain executive power.

As far as the General Professional Regime is concerned its main singularity is that the contract finishes it does not involve right to un-employment benefit (Worker unemployment). Top Management personnel are regulated under Real Decreto 1382/1985, 1st of August. The general characteristics of top management indicate a specific regulation in terms of previous notice of contract termination, non-simultaneity agreements, indemnification for contract termination, etc...

## • Contract Suspension

In specific circumstances, the worker or employer can suspend the labor contract, which involves to interrupt it without terminating it. During the suspension of the contract, the employer does not pay the salaries. The worker will continue in his/her position when the causes that motivated the suspension are over. The contract may be suspended : a) By mutual agreement between the parties, b) For causes set out in the contract, c) For temporary incapacity . Here the employee continues to pay social security, (if the incapacity becomes total, absolute or great invalidity, the contract will be cancelled), d) For maternity of the working woman: The suspension for maternity is 16 weeks, 18 weeks in the case of multiple births. The woman can opt to take 6 weeks before childbirth. The father can use the last 4 weeks, if both work. e) For privation of freedom (in the absence of a condemning sentence), f) By temporary major force, g) Because of strike h) Due to legal closure of the workplace, i) Due to the suspension of work and salary for disciplinary measures; j) For training permission or professional development ; k) To take part in an adaptation or retraining course (maximum of 3 months), l) For adoption and fostering of minors under 5. There are other circumstances that imply suspension of the contract:

- For leave of absence : a) Forced : In some cases, the firm is obliged to suspend the contract and maintain the job post for the employee. The period of leave is calculated according to seniority. b) Voluntary: The position is not maintained, but rather preferential treatment is given when a vacant position arise. c) For child care : With a maximum duration of 3 years, from the birth of the child. Only one of the parents can apply for it, and it doesn't leads to the conservation of the position, except during the first year. d) Circumstances stated in Collective Conventions .
- Due to economic, technical, organizational or production causes, or those derived from force majeure. The existence and temporary character of this causes must be proved and the contract suspension requires future viability. In order to obtain the suspension, the employer must undertake the same process as for an Expediente de Regulación de Empleo, in art. 51 of Worker Law. This circumstances can also be solved with a reduction between a 10% or a 70% of the working day, week, month or year.

## • Permits and Holidays

The worker has the right to absence for diverse causes. The Holiday Period cannot be less than 30 natural days. Holidays cannot be compensated economically and the dates must be known two months beforehand.



## • Employees' Years Of Service

Dismissal compensations are calculated depending specially on employee's years of service in the company that is the reason of temporary contracts lasting over their limits shall be presumed to be for an indefinite period: i.e. temporary contracts (training, relief...) or for a determined duration (a particular works or services) in which the cause is not justified or accredited.

Law 35/2010, on September 17th about the improvement of growth and employment, provided a new wording for article 15.5 of the Workers' Statute, with the following literal reading:

Without affecting the provisions set down in sections 1.a), 2 and 3 of this article, employees who have been contracted for a period over twenty-four months in a period of thirty months, with or without a continuity solution for the same or different work position with the same company, through two or more temporary contracts, whether directly or by being made available through temporary employment companies, with the same or different contracting modes, shall acquire the condition of fixed contracts. This prevention will be also applied to those cases of fusion or combination of societies.

With regard to the peculiarities of each activity and the characteristics of the job, collective bargaining shall establish requirements aimed to prevent the abusive use of temporary contracts with different employees for performing the same job. The provisions of this section shall not be applied to the use of training, relief or substitution contracts.

## • Termination of The Contract – Dismissals

Contracts can be terminated for various reasons, and in all of them the parties are obligated to notify it to the other party. The employer must calculate the appropriate quantity owed to the worker (settlement), always including the proportional part of extra pays and spear holidays, discounting to the worker the advanced payments and holidays in excess. The causes for TERMINATION are:

- Mutual agreement between the parties
- Causes agreed in the contract
  
- **End of the work or service contracted. Temporal contracts, except for temporary and training contracts, grant the employee the right to receive an indemnification of eight days of salary for every year worked. Since September 2010 this regime is being gradually changed:**
  - **Contracts celebrated before December 2011:** 8 days of salary per year of service
  - **Contracts celebrated after January 2012:** 9 days of salary per year of service
  - **Contracts celebrated after January 2013:** 10 days of salary per year of service
  
- **Contracts celebrated after January 2014:** 11 days of salary per year of service
- **Contracts celebrated after January 2014:** 11 days of salary per year of service
- Death, retirement, incapacity or termination of the judicial character of the contractor
  
- Resignation of the employee.
- Permanent total incapacity, absolute or great invalidity of the employee. In case of total permanent incapacity of the worker is declared, the firm can choose to offer him/her another position more fitting with his/her capability. In case of permanent total incapacity or great invalidity, the work contract is terminated, but the position is reserved for a period of two years.
- For legally causes. There are some objective causes which turn a dismissal declared as fair. Objective DISMISSAL of the worker, with an indemnification of 20 days per year worked, limited to 12 monthly payments, in limited circumstance: a) Ineptitude, b) Lack of adaptation of the employee to his/her position, after technical modifications, c) Absenteeism, during a 20% of labor days in two continued months, or 25% of labor days in four discontinuous months, not taking into account periods of: strike, maternity, risk during the pregnancy, holidays, or illness or accident. d) Amortization of job places. (e) Substantial modification of the work conditions that damage the workers professional training or dignity when it does not affect a number of workers enough of collective dismissal.
  
- Collective dismissal. When the process affects a determined number of employees during a minimum period of 90 days. There must be economic, technical, organizational or production causes. The employer must provide proof of their existence and the character of these causes, which might be provoking negative results, or might produce a continued decrease of the incomes. It generates the right to an indemnification of 20 days of salary per year worked, to a maximum of 12 months. In order to articulate these dismissals, an Expediente de Regulación de Empleo is required, which requires a period of discussions between the employers and the representation of the workers, to try to verify the causes of the redundancies, and to set some measures of readaptation for workers that can reduce the damages.
- A unfair cause. When the dismissal is based on causes out of the Law, the judge shall declare by sentence the dismissal was unfair, so the employer will have 5 days to decide the compensation, which might be: a) the readmission of the employee and the salaries unpaid since the dismissal date; or b) 33 days for each year worked, to a maximum of 24 monthly payments and the salaries unpaid since the dismissal date. However, in order to obtain the indemnification, it is necessary to apply for it in the Social Court of Law. (i) Substantial modification of the work conditions that damage the workers professional training or dignity; (ii) Unpayment or continued delays in the payment of the salary agreed; (iii) Any other grave breach of the obligations of the employer (except force majeure) and the refusal of the employer to reintegrate the employee in the same position when a legal sentence has declared it unjustified.

In all of these cases, the dismissal must be notified in written, within previous 15 days expressing the cause and paying the legal indemnification.

- **Disciplinary Dismissal:** Must be based on a grave and guilty breach of the workers' obligations, such as: Repeated and unjustified breaches of attendance or punctuality; lack of discipline or disobedience; verbal or physical offences against the employer, fellow workers or relatives that live with them; breach of contractual faith or abuse of confidence in the course of the job, continued and voluntary decrease in the normal or agreed work yield, habitual and serious drunkenness or drug-addiction with negative repercussions at work.

In relation to Dismissal, it is important to note that if a Legal representative or trade union delegate is dismissed, the process is initiated through an "expediente contradictorio" and the rest of the members of the representation and/or trade union of affiliation are heard.

- Trade union affiliation, being a candidate to represent a trade union, race, sex, civil status, pregnancy, religion, political opinions, etc. can never be a cause for dismissal.
- The Dismissal can be legally challenged within a period of 20 working days, but before going to Court, the case must be heard by the Servicio de Mediación, Arbitraje y Conciliación (SMAC).
- **The Dismissal is declared , in the SMAC (by the parties) or in the Court (by the Judge) as:**
  - Fair, in which case, there is no indemnification.
  - Null, for violation of basic rights or discrimination, in which case, the employee must be reinstated immediately.
  - Unfair, because the circumstances were not as claimed by the employer, in which case, the employee must either be rehired within 5 days or indemnified with 45 days of salary for each year worked, to a maximum of 42 monthly payments. If the employer acknowledges the unfairness of the dismissal within 48 hours of the ruling by the SMAC or the Court, the worker need not claim its legal recognition. If the employer chooses readmission, the worker must be notified within 10 days from the sentence and readmit the worker within a further 3 days. As an exception to the indemnification for unfair dismissal, in the permanent contracting of disabled workers, the indemnification is 33 days salary for each year of service, with a maximum of 24 monthly payments and 12 days of salary for temporary contracts.

• **Summary table of termination of contract**  
(Royal Decree 3/2012)

Cause of termination	Compensation	Compensation	Right to Collect Unemployment
Mutual consent	If agreed		No
Temporary work or service	From 8 to 12 days per year		Yes
Termination clause included in contract	If included		Yes
Worker resignation with compensation	20 days/year	9 to 12 months	Yes
Unfair cause with judicial resolution	45 days/year	42 months	Yes
Unfair cause	33 days/year	24 months	Yes
Worker resignation	No		No
Incapacity	No		Yes/No
Died	15 days		No
Retirement	No		No
Died, incapacity or retirement of the employer	1 month		Yes
Termination with extinction of the corporation	20 days/year	12 months	Yes
Objective/Fair causes	20 days/year	12 months	Yes
Unfair causes	33 days/year	24 months	Yes
Promoting for permanent contracts:			
a) Unfair	33 days/year	24 months	Yes
b) Fair	20 days/year	12 months	Yes

• **The Salary of the Worker. Salary and economic Rights for services rendered**

In consideration of services rendered, the employee may receive money or payment of any kind, and also accrues a right to a month of vacation pay. Two bonus payments per year are obligatory, the amount being fixed by the applicable Collective Convention. IRPF (income tax) and social security payments must be withheld by the employer on these amounts.

The salary comprises the salary base and/or “salary extras”. Remuneration in kind may not exceed 30% of the total salary. The minimum inter-professional wage is the minimum for all professions, is reviewed annually and its amount may not be embargoed for debts of any kind. The minimum wage for any activities in agriculture, industry and services, without distinction between the employees’ sex or age, is set at 23,59 euros/day or 707,60 euros/month, depending on whether the wage is set by days or by months. Both monetary remuneration and remuneration in kind are computed in the minimum wage. This wage is understood to refer to the legal working day for each activity, without including in the case of daily wage the proportional amount for Sundays and public holidays. If the working day is lower than standard then the pro rata amount is to be received.

The delay in salary payment generates an annual interest of 10%. In case of insolvency, the first to receive payment are the employees. In the case of insolvency, the employees are paid by the FONDO DE GARANTIA SALARIAL (FOGASA). All employees and representatives have the right to receive advances. The employer must keep salary receipts and contribution slips for at least 4 years.

Non-salary items are the amounts paid for expenses incurred at work, social security payments and indemnifications for transfers, suspensions and dismissals.

## • **Employees’ Representatives and Union Representation**

The participation of the workers in the Firm can take place through Unitary and/or Trade Union Representation. According to the number of workers in the firm, the Unitary Representation is by the delegation of personnel or firm committees elected by the employees. The Trade Union is the representation of the employees affiliated to the Union. The Law establishes a minimum number of trade union delegates for trade union representation.

Specific responsibilities are conferred to these representatives by Law: to receive information from the employer, to report on certain matters, to carry out monitoring and to control of certain rules, to negotiate agreements with the employer, to participate and to collaborate in the business activity, etc,...and to facilitate exercise of these functions, the employer must provide specific materials (use of premises, notice board) and time (paid), and not to do it may be considered a crime against trade union freedom.

Personnel delegates or committee members are elected every 4 years. The period can be shortened if the representative stands down, is substituted in partial elections or if he/she is revoked by the same employees who elected the delegate or member.

In disciplinary matters, they have the right to receive a prior disciplinary file before any sanction is applied, and if the dismissal is unfair, they can opt for indemnification or readmission. On June 2011, Spain's Government approved new labor reforms, affecting the collective bargaining system. The bill aims to introduce more flexibility within companies so that when they undergo changes or go through difficult situations they can adapt to new conditions.

The main change implies that company pacts shall have more legal weight than Sectoral agreements when conflicts arise. Thus, the COMPANY AGREEMENTS must respect the minimums of national and regional Legislation, but they shall be over Sectoral Agreements in the following areas: Base salaries and incentives, Overtime, Flexible work hours, Job classification and Contract modality. Another measure to increase the flexibility consist on allowing the employer to redistribute 5 percent of employees' work time.

## • Social Security Contributions and Basis For Contributions

The employer pays monthly contributions to social security, consisting of: The Firm's Quota + the Employee's Quota. The payment is made in the month after the month of payment to the employee, through two forms: I) contributions register, where the wages and contributions to be paid are detailed); and II) which is obligatory via Internet if the workforce consists of more than 10 or 15 workers.

To calculate the value of the contributions, we shall multiply the rate legally established by the basis for contribution, deducting the bonuses applicable to the case. The basis for contributions is the employee's monthly salary plus the proportional part of the extra payments and other income of the worker with a periodicity greater than monthly.

Although there are various special regimes, (such as sea workers, artists, bullfighters, etc.) but we will only consider the contributions to the general regime that consist of the following:

- Common contingencies
- Work accidents and illnesses
- Professionals
- Unemployment
- Fondo de Garantía Salarial
- Professional training
- Overtime

Employers must make contributions for all of the above, whereas employees only contribute for common contingencies, unemployment and professional training. The contributions depend on the salary and professional category of the employee, as well as if the contract is permanent or not and the professional activity in which he/she works.

## • Social Security Bonuses

Recent labor reforms establish bonuses for permanent contracting, which effectively reduce the employer’s social security contributions (Information from the Minister of Labor website)

### SOCIAL SECURITY BONUSSES

#### Bonuses permanent contracts

Communities	Description	Amount (Euros)		Term
Older than 45 years old unemployed during a minimum of 12 months before the contract, and registered in the unemployment office.	Unemployed	1.300		3 Years
	Woman	1.500		
Young people between 16 and 30 years old and registered in the unemployment office.	Unemployed	1.000 1st year	1.100 2nd year	3 Years
		1.200 3rd year		
	Woman	1.100 1st year	1.200 2nd year	
		1.300 3rd year		
Other communities under special circumstances	Workers under social exclusion situations	600		4 Years
	Handicapped people	Women	Up to 45	During all the term
	General	4,500	5,350	
	Extreme	5,100	5,950	
Change of Part time contracts to permanent contracts or hiring in substitution of a retirement		Men	500	3 Years
		Women	700	

**Exceptional bonuses to temporary contracts**

<b>Handicapped people hired through the temporary contract measures</b>	<b>Men up to 45</b>	<b>Men from 45</b>	<b>Women up to 45</b>	<b>Women from 45</b>	<b>Term</b>
General	3.500	4.100	4.100	4.700	All term
Extremely handicapped	4.100	4.700	4.700	5.300	All Term
Gender or family violence victims		600			All Term
People under social exclusion		500			All Term

**Bonuses for the maintenance of permanent contracts**

Permanent contracts with employees older than 60 and working during a minimum of 5 years.	50% of the corporation's payments for common contingencies excepting temporary leaves, increasing 10% in yearly basis until 100%	All Term
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**Bonuses for contracts to handicap people by special employment centers**

Permanent contracts, temporary contracts or change of Part time contracts to permanent contracts or hiring in substitution of a retirement	100% of the Social Security Quotas	All Term
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• **Retirement**

The authorities have recently modified the Retirement Policy. Taking into consideration the important repercussion of its effects, it will be implanted progressively. So that from 2013 to 2027 the age of retirement will increase proportionally month by month, and in the end the age of retirement will be 67 years old, and the compensation will be calculated over the incomings of the last 25 years.



- **The Registry System development has stamped Real Estate in Spain**

The Spanish Registry System is a mixture of the French system (where inscription is voluntary) and the German system (where inscription is compulsory). Estate transfer takes place unrelated to the Registry while estate inscription or registration is made by properties: one property per register sheet.

Other basic element that distinguishes the Spanish Registry System from other systems around the world is the Land Registrar, with professional qualifications and his/her enrolled to the office (by a Civil Service Examination).

In Spain, any property is firstly related to legal businesses, and later registration in the Registry provides a pledge to their purchasers before any third party. The Land Registry provides a secure, stable and trustworthy record of land ownership and recorded interests therein, so it promotes social and economic reliability and contributes to national development. The protection of third party's rights by Law in Spain is so high that one of the purchaser's duties of care is to previously enquiry at the Registry about the ownership and encumbrances of the property he/she wants to purchase.

The information and protection provided by the Spanish Land Registry is basic to understand Real Estate in this country. The Spanish Registry System has replaced fiduciary and trustee systems (more frequent in Anglo-Saxon countries) in the field of Real Estate. In fact, practice shows that it is becoming really complex to apply Directive 94/47/EC (Timesharing) through the Ley de Aprovechamiento por Turno de Bienes Inmuebles (Act 42/98), because it is very difficult to match the "Club System" with the Spanish Registry System. The situation is becoming really delicate as Spain is the second country in the world (after USA) on the number of Timesharing resorts.

## • Types of Ownership

In Spain there is the so-called actual right of “ownership” regardless other real property rights such as leasehold, possession - in deed or bare or bona fides ... -, accretion, easement, emphyteusis, antichresis, usufruct, mortgage, acquisitive prescription... All of them are inspired by Roman Law, on which Spanish Law is based.

Timesharing is called “Aprovechamiento por Turno de Bienes Inmuebles” in Spain; it is an atypical real property right and is regulated by Act 42/98 in Spain. Act 42/98 requires the resorts to register their structure and working in the Land Registry; it mixes thus the Anglo Saxon Fiduciary system with the Spanish Registry System, and creates some missfunctions very difficult to solve. For instance, any clause that may exonerate promotor’s liability is null.

## • Land Register (if appropriate)

The Real Property Registration in Spain is managed by Land Registry Offices throughout the whole country which registers, stores and manages documents such as deeds, mortgages, plans of survey and a wide range of property real rights. All registered and deposited records are available to the public (for a fee) to search title or to obtain information about the ownership of any real property.

The Land Registry’s object is to register the acts and contracts related to ownership and other real rights on real estate (rentals, usufructs...) However, the bare (or naked) possession can not be registered in the Land Registry.

To be registered those acts or contracts must be have been recorded as a public instrument or been acknowledged by a judicial authority or by the Government.

Moreover, any acts or contracts granted in a foreign country which are having effects in Spain (Apostille ...), have to be entered in the Spanish Land Registry.

- **The Land Registry attests the title against third-parties**

Those who acquire their right from a person who appears in the Registry as entitled to transfer that right, are supposed to possess the real estate according to *bonas fides* requirements. So their possession is going to be presumed as according to Law once that they register their right. Even though the seller's right is set aside or discharged for reasons that are not recorded in the Registry.

The third party's *bona fides* is presumed as long as any third party can prove that the information recorded in the Registry was not accurate.

**Caution:** Holders of any title acquired gratuitously do not enjoy the same protection.

The parties in a contract are not required to register the acquisition of a real right. However, the registration is highly recommended, because it implies a presumption of legality and it is a prove itself against third parties who claim a right on the same real estate. The rights that have not been recorded in the Land Registry are presumed as a "manifest negligence and a clear breach of duty of care"; it does not mean it is illegal but it may cause damages to the purchaser or the real right holder that has not entered it.

Another important question is the difference between the Land Registry and the Cadastre or Land Survey.

The Land Registry records and states real estate ownership. On the other side, the Cadastre represents real estate through a more detailed and graphical description. The Cadastre's purpose is related to its tax functions.

- **Reliance on register positive-negative**

Registration is considered negative because once a first entrance is registered in the Land Registry, any intend of registration coming afterwards are going to be refused, until you prove the transfer. Transfer formalities e.g. notary deed

To be able to reap the benefits of the protection provided by the Land Registry, any holder must communicate the acts or contracts which can modify, transfer or extinguish any real right on any real estate. Moreover, any real estate leasehold for six or more years must always be entered in the Registry.

- **Mortgages. How they are created, and main rights of mortgagees**

A mortgage gives a security for all kind of liabilities and does not alter the debtor's limitless responsibility. A mortgage covers improvements and betterments as well as any compensations granted or due to the owner. However, a mortgage does not cover any personal property, proceeds or any earnings due and not paid, express agreement excepted. Any real estate, any real property rights (save easements), any legal usufruct (save the usufruct granted by the widowed spouse) can be mortgaged.

- **Construction and use restrictions**

The carrying out of any works or building requires a licence: Licencia de Obra Mayor (with a large budget or works on structural elements) and Licencia de Obra Menor (a sensu contrario). In any case, the Municipal Ordinances and the Local Building Code define the differences between a Licencia de Obra Mayor (Large Works Licence) and a Licencia de Obra Menor (Minor Works Licence).

Moreover, any land or underground usage (partitions, land movements, demolition ... ) requires a permit that is regulated in the Local Zoning Regulations.

The Zoning Regulations ascribe different usages (residential, turistic, tertiary) to each land class (urban land, land which may be developed, or protected land that can not be urbanized). Land usage and land classes limit building rights. In addition, each type of land has a percentage of urban development permitted.

Any license is subjected to the payment of a fee called Impuesto sobre Construcciones Instalaciones y Obras which has to be paid by the owner. This tax is calculated by applying to the current costs of the building or the works, a rate that is determined by the Town Hall, and will NOT be over 4%. The application for the permission requires a Technical project signed by an Architect and approved by the Architects Professional Association.

The Technical Project is carried out by the Work Manager -who is responsible for it- who may be or not the author of the Technical Project. Local Building Codes do not require a dateline of the works. It is usual for the owner to keep an amount of money (a percentage) from the promotor as a guarantee for the proper completion of the works.

# Moll Wendén Advokatbyrå AB

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Sweden

## 📍 Head Office

Stortorget 8, SE-211 34  
Malmö, Sweden

☎ (+46-40) 665 65 00

☎ (+46-40) 97 19 17

info@mollwenden.se

www.mollwenden.se

## General information

MOLL WENDÉN's business concept is to offer high quality legal advice to large or medium sized corporations. MOLL WENDÉN has its offices in Malmö, Sweden, in the heart of the Öresund region. The Öresund region mainly consists of the southern part of Sweden and Själland (Copenhagen) in Denmark. The region, with its 3.9 million inhabitants, is a transnational region within the EU.

MOLL WENDÉN offers first-rate competence in company law, mergers and acquisitions, financing, real property transactions, litigation, IT and telecom, intellectual property, labour law, competition law and public procurement. The lawyers at MOLL WENDÉN have sector-specific expertise in areas such as the food industry, real property and construction, pharmaceuticals and biotechnology as well as IT and telecom. Therefore, do not be surprised if our lawyers show a particular interest in your line of business and affairs.

MOLL WENDÉN is an established law firm with traditions. The partners of MOLL WENDÉN have worked with international clients and assignments for ten to twenty years; first at Lagerlöf & Leman and then at Linklaters. All of the associates at MOLL WENDÉN are experienced in handling international matters. The partners and associates at MOLL WENDÉN are used to working in large organisations and international networks - something that clearly influences our idea of a first-class legal assistance. MOLL WENDÉN has a large number of international clients whose common denominator is the demand for Swedish expert legal advice.

# Sweden | CORPORATE LAW

The Swedish corporate law is largely based on the written laws that apply to each specific kind of legal entity that is available in Sweden. A Swedish business can be conducted as a trading partnership, as a limited partnership, as an economic association or as a sole trader (which is not a legal entity). As in other EU-countries, it is in Sweden also possible to establish a European company (SE) in accordance with the Council Regulation (EC) No 2157/2001 and Council Regulation (EU)517/2013 of 13 May 2013, and, as in other EEA-countries, to register a European Economic Interest Grouping (EEIG). However, these legal entities are normally not chosen by foreign companies and investors when establishing a business in Sweden and they will therefore not be part of this description of the Swedish corporate law.

Foreign companies and investors establishing a business in Sweden most commonly form subsidiaries in the form of limited liability companies. An alternative is to set up a branch office in Sweden. The Swedish law for limited liability companies and the alternative to use a branch office are described below.

## • Limited liability companies

### GENERAL

There are two kinds of limited liability companies in Sweden; private and public limited liability companies. Public companies may distribute their shares to the public, which private companies may not. The vast majority of the companies in Sweden are private companies. The company name of private companies may not include the word “public” and the names of public companies may not include the word “private”. Some rules in the Swedish Companies Act (the “Act”) (Sw. *Aktiebolagslagen*) apply only to either type of company. However, most rules in the Act apply to private as well as public companies. In addition to the Act, companies which are quoted on the Stockholm Stock Exchange must follow certain set of rules which apply to quoted companies only.

## **FORMING A LIMITED LIABILITY COMPANY**

A limited liability company is formed by one or more founders. A founder may be any natural person or legal entity. The founders shall sign a memorandum of association which shall contain certain information including articles of association for the company. All shares in the company shall be subscribed for in the memorandum of association.

The articles of association shall contain certain information as stated in the Act, for example information about the financial year of the company. The financial year shall be the calendar year or 1 May–30 April, 1 July–30 June or 1 September–31 August. It is however also possible to apply for permission to adopt any other twelve-months period as the financial year of the company.

Before the company can be registered with the Swedish Companies Registration Office (the “SCRO”), the share capital of the company must be paid to the company by the founders of the company. The minimum share capital of a private company is SEK 50,000 and of a public company SEK 500,000. The share capital may also, subject to certain rules, be contributed in kind to the company.

The board of directors (see 2.4 below) shall register the shares in the share register of the company. Shareholders may be residents of any country. When the shares are transferred to new shareholders, the new shareholders must be entered into the share register. Shares in quoted companies are registered electronically through a system known as Euroclear Sweden. Companies that are not quoted may in their articles of association prescribe that the shares may be registered in Euroclear Sweden. Share certificates may be issued and shall be issued to a shareholder which presents such request. Share certificates may not be issued in companies that use the VPC-system. Shareholders in companies that use the Euroclear Sweden-system can instead prove their ownership of certain shares through a print-out from the Euroclear Sweden-system.

## **BUYING AN “OFF THE SHELF COMPANY”**

If a company is needed with short notice, an alternative to forming a new company may be to acquire an existing limited liability company (which always is private) that previously has conducted no business, i.e. a so-called off the shelf company. Such a company can normally be acquired very quickly, provided that the share capital of SEK 50,000 is transferred to a new bank account in the name of the company.

## MANAGEMENT

The board of directors is elected by the shareholders at a shareholders' meeting. The board is responsible for the operations of the company. Normally, the directors are elected at the annual shareholders' meeting until the next annual shareholders' meeting. However, the directors can be discharged from their position at any time prior to the next annual shareholders' meeting by resolution at an extraordinary shareholders' meeting.

A public limited liability company must have a board with at least three directors. In private companies, the board may consist of only one or two directors provided that at least one alternate director is elected. If the board consists of more than one director, a chairman of the board shall be elected by the board. At least half of the directors and the alternate directors must be resident within the EEA (it is possible to apply for an exemption). If no board member, no managing director and no special authorised signer (which can be appointed by the board) has its residence in Sweden, the board of directors must grant a power of attorney to a person who has its residence in Sweden to accept service of process for the company.

Public companies shall and private companies may appoint a general manager. The general manager will have authority to represent the company in all matters that fall into the day-to-day management of the company. The managing director may be discharged at any time by the shareholders' meeting or by the board of directors (subject of course, from a labour law perspective, to his employment contract). The managing director shall have its residence in the EEA (it is possible to apply for an exemption).

The founders, directors of the board or the managing director may be liable to pay damages if they wilfully or negligently cause the company damage when performing their duties. The founders, directors of the board or the managing director may also be liable to pay damages if a shareholder or another person suffers damages through a violation by the director of the Act, of the Annual Accounts Act or of the articles of association.

There is no requirement for Swedish limited liability companies (except for quoted companies) to appoint a secretary of the board of directors.



## SHAREHOLDERS AND SHAREHOLDERS' MEETINGS

Within six months from the expiry of each financial year, an annual general shareholders' meeting shall be held in the company at which the annual report shall be presented. In addition to the annual general shareholders' meeting, it may in the articles of association of the company be stated that other general shareholders' meeting shall be held during each year. Additionally, the board of directors may at any time during each year convene extraordinary shareholders' meetings.

A shareholder has a right to participate at a shareholders' meeting if the shareholder at the day of the shareholders' meeting has been entered into the share register. In companies that use the Euroclear-system, the shareholder shall be stated in the share register on the fifth day (or at a later day if stated in the articles of association) before the shareholders' meeting to have a right to participate at the shareholders' meeting.

Most decisions can be adopted by the shareholders' meeting by simple majority. However, some decisions, such as amendments to the articles of association, require qualified majority. Normally, all shares have equal voting rights but it is possible, by the articles of association, to prescribe that there shall be shares of different classes and that these shares shall have different voting rights.

A shareholder may be liable to pay damages if such shareholder wilfully or by gross negligence causes damage to the company, to any other shareholder or to another person if the shareholder participates in a violation of the Act, of the Annual Accounts Act or of the articles of association.

## ACCOUNTS AND AUDITS

All companies carrying on a business activity are under an obligation to maintain accounting records under the Bookkeeping Act (Sw. Bokföringslagen) and are required to adhere to generally accepted accounting principles. The annual accounts and the audit report, as adopted by the annual shareholders' meeting, must be submitted to the SCRO within seven months from the expiry of the relevant financial year, i.e. on 31 July at the latest for companies with the calendar year as financial year.

The company shall, by a resolution at the shareholders' meeting, elect the auditor or the auditors of the company. Only authorised or approved public accountants or a registered accounting firm may be elected as auditors. The auditor examines the company's accounts and the board of director's management of the company. The auditor is not allowed to also keep the company's current accounts. The auditor's

mandate period is normally one year. However, in the article of association it may be stipulated that the auditor's mandate period may be longer than one year. In any case, the term of office shall expire at the end of the Annual General Meeting which is held during the fourth financial year following the appointment of the auditor. The auditor may resign in advance or be discharged in advance by a resolution at a shareholders' meeting

## REGISTRATION FOR TAXES

Employers must register as such by filling in the form "Företagsregistrering" and send it to the Swedish Tax Agency. On registration, the employer will automatically be sent documents and information required in order to account for and pay VAT, income tax and social contributions.

## STATIONERY

The letters, invoices and order forms of limited liability companies must state the name of the company, the place where the registered office of the board is located (as stated in the articles of association) and the corporate registration number issued by the SCRO.

## • Branch office

### GENERAL

According to Swedish law, a branch office is not an independent company, but an office through which a foreign company runs its business in Sweden. Naturally, the branch has no share capital of its own.

Permission for the foreign company to establish a branch office in Sweden is not necessary, but the branch office has to be registered with the SCRO and there are a number of specific requirements for such a registration.

The name of the branch office shall include the foreign company's name with the addition of the Swedish word "filial" (which means branch) or "filial till" (which means branch to). It must be possible to distinguish the name of the branch from other existent firms registered in Sweden.

## **MANAGEMENT**

The branch office shall be run by a managing director. The managing director shall be resident in Sweden or any other country within the EEA. A person under age, declared bankrupt or who has an administrator cannot be appointed managing director. If the managing director is not resident in Sweden, the company must authorize a person resident in Sweden to receive summons and other legal documents on behalf of the branch. The requirements for this person correspond to the requirements for the managing director.

The foreign company shall give a power of attorney to the managing director to represent the foreign company in all matters concerning the business in Sweden, including the right to receive summons against the foreign company and to represent the foreign company in court. Additionally, one deputy managing director can be appointed.

## **ANNUAL ACCOUNTS**

The branch shall appoint an authorized or approved auditor or registered accounting firm to review the accounts of the branch and the managing director's management of the branch. The managing director shall each year supply SCRO with the annual report for the branch office as well as for the foreign company. (As concerns the foreign company the requirement is only applicable if the documents are public in the home country of the foreign company.) If the foreign company is a limit liability company resident within the EEA, a limited annual report may be produced instead of a formal annual report.

## **ACCOUNTING**

The branch shall have its own book keeping which shall be separated from the foreign company's book keeping. Generally, the accounting records of a branch shall be kept in Sweden. However, an exemption makes it possible to keep the records on electronic media in another country within the EEA, provided that the Swedish Tax Authority has been notified of the place of storage and provided that the branch always can get immediate access to the accounting records through a print out in Sweden.

## **STATIONERY**

Letters, invoices and order-forms of the branch must state the name and address of the branch as well as the foreign company's legal status and domicile.

# Sweden | TAX LAW

Limited companies and certain other legal persons must pay a corporate tax of 22 per cent. The tax is deducted from the enterprises pre-tax results of operations, subject to certain fiscal adjustments. The tax rate for individuals as regards income from employment and partnerships is progressive and varies between 28 and 58 per cent depending on the amount of income. Capital gains tax varies between 20 and 30 per cent.

## • Taxation of resident companies

All income received by a company is dealt with together, regardless of whether it originates from different kinds of activities. Thus, losses from one activity may be set off against income from another. Losses from business activities carried out abroad may be set off against income from Swedish activities if there is no tax treaty stipulating that the foreign income should be tax exempt. Calculation of a company's taxable income is based on the annual report prescribed by civil law and the fiscal income assessment is based on the realised results of operations.

## • The allocation reserve

A deductible allocation reserve may be made at maximum of 25 per cent of net earnings prior to allocations for the financial year. The allocation must be recognised in the financial statements of the limited company.

The allocation reserve must be reversed for tax purposes no later than in connection with the tax assessment of the 6th fiscal year following the year when the provision was made. If no voluntary reversing entry has been made, the remainder will be reversed mandatorily. Each year's provision constitutes a reserve of its own. Consequently, a company can have a maximum of six allocation reserves at time. The company is not required to make payments into a special purpose account or similar.

## • Depreciation and deductions

Normal expenses incurred in the course of business are deductible when determining the taxable income. Assets which are held for permanent use may be depreciated on the bases of the actual acquisition cost. Companies may choose between using the declining balance method at 30 per cent per year and the straight lane method at 20 per cent per year. Assets with an expected useful life of less than three years may be written off at once, as may assets of minor value.

Real estate is depreciated using the straight lane method over the expected useful life of the property. Usually commercial properties may be depreciated by 2 – 5 per cent per annum, factory premises by 4 per cent and office properties by 2 per cent per annum. Interests and royalties are generally fully deductible.

General Swedish taxes paid are not deductible according to Swedish law. Sweden has no rule on thin capitalisation. Consequently, there are no restrictions on interest payments between related parties, as long as these are made on an arm's length basis. Dividends paid are not deductible. If the company suffers a loss one year the loss will become deductible the following year. The taxpayer may not choose when to use the loss but it may be carried forward without time limitation if the loss is not covered by profits in the subsequent year. However, some limitations apply to this rule if the company suffering the loss is sold.

## • Group taxation

Limited companies are treated as groups where a parent company directly or indirectly holds more than 50 per cent of the voting powers of another limited company.

A group is not a taxable entity in itself but companies in the same group can make certain fiscal redistributions of their earnings. The owner may through intra-group transfers obtain a tax allowance if the donee books the transfer as taxable income. For intra group transfers to take full legal effect the following requirements apply. The companies concerned must be Swedish limited companies. The parent company must have owned more than 90 per cent of the shares in the subsidiary during the entire financial year or both the donor and the donee must be subsidiaries of the same parent company which owns more than 90 per cent of the shares in each of the companies. Subsidiaries, which render or receive transfers, must have been wholly owned during the entire fiscal year for both donors and donees or since the subsidiary commenced conducting business activities in some kind or other. Either

the donor or the donee may be housing, investment or management company. Both the donor and donee must disclose the intra group transfer during the same fiscal assessment year in the tax return. Nor must shares in the subsidiary constitute a stock asset in the parent company.

In some cases, a parent company is exempt from tax on dividends received from foreign subsidiaries if the foreign company is subject to a tax at a rate comparable to Swedish taxation of similar entities or is recognised as a company in a Double Taxation Treaty to which Sweden is a party.

## • Taxation of foreign companies

Whereas a company that has been duly incorporated and registered under Swedish law will be taxed in Sweden on its world-wide income (total tax liability), a foreign company will only be taxed for income deemed to derive from Swedish sources (limited tax liability). The latter rule applies mainly to income attributable to real property or to a permanent establishment located in Sweden. A foreign company will be considered to have permanent establishment in Sweden when its operations are carried out through a fixed place of business, i.e. a branch office. An agent with power to conclude contracts on behalf of a company will normally qualify as a permanent establishment. Unrelated agents, for example a reseller, will not constitute a permanent establishment as long as the assignment carried out on behalf of the foreign company is within the agent's usual type of business.

## • Business related shares

Sweden has rules regarding business related shares (*Sw. näringsbetingade aktier*). The rules apply to limited liability companies (*Sw. aktiebolag*) as well as partnerships (*Sw. handelsbolag*). A holding company's shares in other companies are regarded as business related if one of the following criteria is met:

- The shares are not listed on any stock exchange or similar market place (unquoted shares)
- The shares represent 10 per cent or more of the voting power in the company
- The business of the holding company or its subsidiaries is related to the business of the company held

Dividends from unquoted shares and other business-related shares are tax free for the holding company with only a few exceptions. There are for example exceptions for dividends from controlled foreign companies in certain tax haven countries.

Generally, capital gains on sale of business related shares will be tax free for the holding company. However, a few exemptions worth mentioning apply to this general rule. If a business-related share is quoted it must have been held for a year or more. Another exception regards sales of shares in shell companies, i.e. companies holding primarily lots of cash or other liquid funds but few other assets.

## • Double taxation

Swedish domestic law provides two main alternatives for avoiding international double taxation:

- Foreign tax may be deducted as a cost when calculating the taxable income of the company, provided that the income in question is taxed in Sweden
- Foreign tax may be credited against Swedish tax using the over-all method. However, the foreign tax assessment must be final, compared to Swedish tax, and levied on the basis that the income originates from the country in question

The latter alternative may be utilised even if there is a treaty covering the situation provided that the treaty does not prescribe exemption from Swedish tax.

Sweden also has an extensive network of tax treaties. There are no Swedish laws on treaty shopping, but provisions on this subject, mainly concerning dividends, may be included in some of the more recent treaties. Most of the treaties are based on the ACCE-DE model convention.

## • Partnerships and limited partnership

Partnerships and limited partnerships are legal persons that can enter into legal and binding agreements etc. Despite this, it is not the partnership/limited partnership that is subject to pay tax on its income. Instead each of the co-owners is taxed on his share of the profits of the partnership.

The co-owners of the partnerships will be taxed in Sweden on income earned by the partnership through its business transactions in Sweden. If the overseas owner in a partnership is an overseas company, the tax charge will be the same as had the operations been conducted through a branch office.

Although the co-owners are subject to tax on the income of the partnerships, a joint assessment of income must be made for the partnership as such. The co-owners will then be taxed for their shares of the profits of the partnership.

## • Value added tax VAT

VAT is levied on the sales price of taxable goods or services. At the present three rates apply, a standard rate of 25 per cent and two reduced rates of 12 and 6 per cent. The reduced rates of 12 per cent applies to food (excluding alcoholic beverages), hotel services, camping sites and ski lifts while the lower reduced rate of 6 per cent applies to for example daily papers, magazines, books and passenger transportation. Anyone who commercially trades taxable goods or services in Sweden is liable for VAT. Every two months, or if the company is trading with other EU member states every month, the difference between the VAT received from the selling of goods and services and the VAT paid for the acquisition of goods and services is paid to the state. When the latter exceeds the former the company will receive a refund.

## • Individual taxation

Residents of Sweden pays Swedish tax on all income irrespective of whether the income is earned inside or outside the country. You will be regarded as a resident of Sweden if you stay in the country for more than six months, or if your fixed domicile lies in Sweden. You can also be regarded as a Swedish resident if you have some connection with the country, for example Swedish citizenship, property or business operations. The latter pre-supposes, however, that you have previously been regarded as a fiscal residence of Sweden, i.e. if your true domicile has been in Sweden.

The tax liability in Sweden for non-Swedish residents is limited to the income earned in Sweden. The income tax system somewhat simplified consists of three brackets:



- **Tax bracket 1:** Municipal income tax on taxable income not exceeding SEK 438 900 (2017). Varies between circa 28 and 33 per cent depending on municipality. The average municipal tax during 2016 was approximately 32 per cent
  - **Tax bracket 2:** State income tax of 20 per cent in addition to the municipal income tax for incomes exceeding SEK 438 900 (2017)
  - **Tax bracket 3:** Surtax of 5 per cent in addition to the municipal income tax and state income tax on incomes exceeding SEK 638 500 (2017)
- **he highest marginal income tax rate is thus between circa 53 and 58 per cent depending on income and location**

A company is obliged to pay preliminary tax when paying salary to its employees. The preliminary tax to be paid in respect of each employee varies depending on the employee's domicile and his or her expected annual income. In addition, each employer is obliged to pay a statutory payroll tax of (31,42 per cent) of the remunerations paid. Individuals must pay a 20 to 30 per cent tax on capital gains.

## • Other taxes

### PROPERTY TAX

The state property tax on owner-occupied houses and apartment buildings was abolished in 2008. Instead, a "local/municipal fee" was introduced with a cap, to be adjusted annually and was indexed to the so-called income base amount (inkomstbasbelopp), which tracks the average nominal income. The state property tax, however, still applies to properties which are not considered as residential properties, i.e. an unbuilt plot of land.

### EXCISE DUTIES

In addition to general VAT, duties are imposed on several goods. Notable examples include fuel, tobacco, electricity and alcohol. Rates on fuel are set to increase automatically and annually from the year 2017 at a rate calculated using the consumer price index (CPI) plus two percentage points. In practical terms, the above means Sweden may have the highest fuel taxes in the world by the year 2020. VAT is levied on all excise duties.

### STAMP TAXES

Certain stamp taxes apply in connection with transfer of real estate and issuing of mortgages in real estate, companies (floating charges), air crafts and vessels. The stamp taxes applicable to real estate are further described under "Real Estate".

# Sweden | FOREIGN INVESTMENT

For several years Sweden has been encouraging foreign investments. Sweden has plenty to offer to foreign investors such as simple business procedures, low corporate tax rates, good infrastructure and a well-educated labour force and is generally considered to be an attractive country to invest in. Few provisions regarding investments in Sweden distinguish between domestic (Swedish) and foreign investors.

## • Registration with Government, Authorities and Permits

There are various ways to do business in Sweden. One alternative is for the foreign investor to form an alliance with an existing independent Swedish business on a contractual basis. Another alternative is to run its own business in Sweden - without obtaining any specific authorization. A foreign investor wishing to set up a business in Sweden has the alternative to conduct business via different kinds of partnerships or as a limited company. The latter can be either private or public. Foreign companies also have the possibility to set up a branch office (a local office with an independent administration). The most common way to set up a business in Sweden is to create a Swedish subsidiary (generally a limited liability company) to the foreign company.

There are no requirements for foreign investors to register or obtain authorization for making investments in Sweden. All business units in Sweden are on the other hand subject to registration at the Swedish Companies Registration Office (SCRO) (Sw. Bolagsverket). The public commercial register contains basic information about the legal entity, its business and its representatives. The cost of establishing a Swedish limited liability company is relatively low.

There are no general Swedish restrictions in relation to foreign ownership of shares. In a limited liability company, however, at least half of the board members as well as the managing director must reside within the EEA. But regarding residents from outside the EEA and the managing director, the company may apply for an exemption at the SCRO. Should no board member reside in Sweden, the board must authorize a Swedish resident to receive documents on behalf of the company.

Foreign investors may acquire Swedish real estate for commercial use without applying for governmental permission. Specific permits and authorizations may be

generally required to engage in certain types of businesses and to carry out certain types of activities. Foreign entities are however generally treated as equals to Swedish entities when applying for such permits and authorization.

- **Registration of beneficial owner**

On 20 June 2017, the Swedish parliament enacted a law on the registration of beneficial owners, which came into effect on 1 August 2017 and was based on the EU's fourth Anti-Money Laundering Directive, which has been implemented or will be implemented in all EU Member States. The law aims to prevent money laundering and the financing of terrorism through an increasing transparency of ownership and control of companies, associations, trusts and other associations (legal persons). According to the law, a legal entity will be obliged to notify the Swedish Companies Registration Office of its beneficial owners. A beneficial owner is (i) any individual which ultimately owns or controls the legal entity and/or (ii) the individual on whose behalf a transaction or activity is being conducted. The latter is characterized as a person enjoying the benefits of someone else's action. The duty to notify the Swedish Companies Registration Office will attach to all Swedish legal entities, foreign legal entities operating in Sweden who have not made a corresponding notification in another EEA country, as well as persons domiciled in Sweden who manage trusts or similar legal arrangements. Limited companies listed on a regulated market are among the entities that are exempt from providing notification.

- **Transfer of Dividends, Interest and Royalties Abroad**

There are no restrictions in Sweden regarding the dividends a Swedish corporation may transfer to foreign owners or shareholders, nor are there any restrictions on remittances of interests or of royalties.

In the absence of an applicable double taxation treaty, dividends payments beneficially owned by a foreign person are subject to withholding tax. The tax rate is significantly reduced under most tax treaties. Due to tax treaties dividends paid by a subsidiary in Sweden to its foreign parent company may not at all be subject to Swedish source taxation.

## • Repatriation Procedures and Restrictions

Investments are not subject to foreign exchange controls and there are no restrictions on repatriation.

## • Foreign Personnel (permits etc.)

The requirements about residence permits and/or work permits for foreign personnel who are to be sent to Sweden depend on whether they are EU/EEA citizens or not.

EU/EEA citizens do not need work permits to work in Sweden. However, generally a residence permit (which will formally record the individuals for tax and social benefit purposes) is required for any citizen visiting or staying in Sweden for more than three months.

Non-EU/EEA citizens must obtain work permits to work in Sweden. The work permit must be obtained before arriving to Sweden. It is quite difficult for non-EU/EEA citizens to obtain a Swedish work permit. However, work permits may be granted in cases of temporary shortage of labour or if the work requires employees with specialist knowledge whose equivalents are hard to find on the Swedish employment market. An application for work permit shall include housing provisions, guarantees of work and minimum wages. Work permits are initially granted for a one-year period but may be extended. Specific additional requirements may apply depending on the nationality and domicile of the foreign individual. Like EU/EEA citizens, non-EU/EEA citizens need a residence permit to stay in Sweden for longer consecutive periods than three months. For stays shorter than three months a residence permit is not needed but instead a visa may be required for some foreign citizens. Generally, foreign citizens are subject to the same taxes as the Swedes. Taxes for foreign key personnel may be reduced.

## • Grants

There are a wide range of investment incentives provided by the Swedish Government and regional authorities, e.g. grants such as regional development support. Most of these incentives are available to foreign as well as Swedish investors.

## • The employment contract

### GENERAL

In Sweden, binding employment contracts can be made orally or in writing. However, under the provisions of the Swedish Employment Protection Act (1982:80), employers must provide each employee with a written statement of the terms and conditions of employment within one month after the commencement of the employment. The statement shall include the following details:

- Name and address of the employer and the employee
- The form of employment, i.e. if the employment is permanent, on trial or a fixed-term employment, including information on notice period and trial period for permanent employment, and conditions triggering termination of a fixed-term employment, such as the expiration date
- The place of work and the commencement date
- Conditions in relation to work to be performed outside Sweden, if such work is intended to last more than one month. Any amendment to such terms and conditions must also be communicated in writing to the employee within one month
- The employee's position or work duties
- Information on normal working hours and paid holidays
- The applicable collective agreement (if any)
- Wages and other benefits, including payment intervals

**Such statements are not necessary for employments lasting less than three weeks**

### FORMS OF EMPLOYMENT

The main rule is that employment contracts are concluded for an indefinite term (permanent employment), unless otherwise agreed. Agreement can also be made on probationary employment with a trial period of up to six months. A probationary employment transforms into a permanent employment unless terminated according to certain procedures prior to the expiration of the trial period. Regulations regarding fixed-term employment is restrictive and complicated. The general rule, states that any fixed term contract will automatically be converted into a permanent employment if the employment through fixed-term contract cumulatively lasts 24 months in a given five-year period.

The given period (five years) may be extended if the fixed-term contracts are used in combination with substitute employments, paid internships or seasonal work. It is important to note that gaps up to six months between different types of employments does not affect the view of the employment period as “unified” and thus will lead to conversion into a permanent employment.

## • Wages and benefits

Wages and other financial benefits (except holiday pay) are not subject to any legislation in Sweden, not even regarding minimum pay rates. Considering the pervasiveness of collective agreements, especially regarding blue-collar workers, the collective agreements in practice constitute *de facto* minimum rates, leaving little room for individual agreements. White-collar workers on the other hand predominantly negotiate wages and other benefits locally either through their union or individually. In the absence of any collective agreement, wages are negotiated between the employer and the individual employee. Compensation for overtime hours is extensively regulated in most collective agreements.

## • Trade unions and collective agreements

### GENERAL

Trade unions play a very important role in Sweden. The legal relationship between employer and employee is to a large extent regulated in collective agreements. The Swedish Co-Determination at Work Act (1976:580) contains the general provisions governing the relations between the employer and the unions. The Act sets forth the rights of employers and employees to associate in and act through organisations without interference by the other party. Moreover, the Act includes the basic provisions in relation to conclusion, interpretation and termination of collective agreements as well as the legal implications of such agreements. Collective agreements are legally binding on the signatory parties as well as members of such organisations. Moreover, collective agreements take priority over individual employment contracts. Breach of a collective agreement may result in liability for the employer to pay damages (including punitive damages). When a collective agreement is concluded, the parties to it, in principle, cannot legally take industrial action in relation to any issue covered by the agreement.

A trade union that has concluded a collective agreement with the employer acquires a privileged position at the work place, including rights to negotiate and receive information in relation to redundancies and many other issues that may occur. At workplaces where the employer is bound by a collective agreement with a trade union, terms and conditions of the collective agreement apply directly to employees being members of the relevant trade union and it is a common understanding that the employer generally must also provide non-members the same wages and other terms and conditions as the collective agreement provides. Moreover, collective agreements frequently affect employers not bound by such agreements. The reason being that industry-wide collective agreements are generally held to set standards to be applied at all workplaces in that particular sector.

## EUROPEAN WORKS COUNCIL

The European Works Council Directive (2009/38/EG) has been implemented in Sweden by the adoption of the European Works Council Act (2011:427). Accordingly, Swedish employers qualifying to set up a European Works Council must comply with specific consultation requirements on a European level.

### • Termination of employment

#### GENERAL

Dismissal on part of the employer must have just cause in order to be valid. Reasons for dismissal can be divided into two main categories, one being redundancy, the other being the employee's personal conduct. Certain employees, primarily those holding a managerial position, are not protected by the mandatory minimum requirements on employment protection in case of for example dismissal. If an employee who has been dismissed without just cause brings action against the employer, the Labour Court may declare the dismissal invalid and order the employer to pay damages, which may be considerable.

#### DISMISSAL FOR REDUNDANCY

The employer decides whether a redundancy situation is at hand or not. In principle, no distinction is made in Sweden between collective redundancies involving a large number of employees, and a redundancy situation involving only one single employee. Notice of termination by the employer must be given to the employee in writing and include detailed information on what the employee shall observe if he or she wishes to challenge the termination or claim damages. The notice must also state whether or not the employee has a right to re-employment if a vacancy should arise within a certain period of time.

When notice of termination is given by the employer, an employee having concluded an employment agreement subsequent to 31 December 1996 has a mandatory notice period of between 1 and 6 months depending on his total period of employment with the employer. For employees having entered into an employment contract prior to 1 January 1997, the notice period is instead determined on the basis of the employee's age.

In a redundancy situation, the employer is obliged to pay salary and all other benefits to the employee during the notice period even if the employee is relieved

from his duty to work. The employer is, however, entitled to deduct income which employee receives from another employment during the notice period.

An employer must prior to a decision regarding important alterations of the business operations, on his own initiative, negotiate with all trade unions to which he is bound by collective agreement provided that such unions have at least one member employed by the employer. A decision, which may result in redundancies, is always considered to be of a nature that requires prior negotiations. Employers who are not subject to any collective agreement are obliged to negotiate with all trade unions having at least one member employed by such employer, if an intended decision may result in redundancies.

The obligation to negotiate with the unions implies that negotiations must not only be initiated but also finalised prior to a decision by the employer to restructure and subsequently terminate the employment contracts with employees affected. Provisions on the negotiation procedure are often included in local or central collective agreements. The negotiations are intended to result in an agreement and include an obligation for both parties to present motivated proposals for a solution of the subject matter of the negotiation. The Labour Court may award damages to the unions if it is held that the employer has failed to fulfil the obligation to negotiate.

In a redundancy situation, the employer is primarily obliged to find alternative work for the employees within the company. This means that the employer must offer any vacant positions to employees threatened to be made redundant, provided that they have the basic qualifications to resume such positions. Furthermore, the employer shall observe rules regarding seniority, the rule of first in – last out applies. Collective agreements frequently supersede the legal requirements regarding e.g. notice period, seniority rules and rights to re-employment. Especially the collective agreements for salaried employees generally provide for notice periods exceeding the legal minimum requirements.

## **DISMISSAL FOR PERSONAL REASONS**

According to the Employment Protection Act, an employee may be dismissed for personal reasons in either of two ways. Firstly, dismissal can be made with notice where the same notice periods and other requirements apply as outlined above in relation to dismissal for redundancy. The second alternative is immediate dismissal without notice. Both options require the employer to have just cause for the action taken. Accordingly, the employer must substantiate a failure by the employee to comply with his obligations under the employment in such a material manner that the employer is not obliged to maintain the employment relationship. As the meaning of “just cause” is not defined in the Act, there are numerous precedents from



the Labour Court to take into consideration. It should be emphasised that in order to arrive at a just cause for dismissal for personal reasons, the employer has the full burden of proof to prove both the employee's failure to comply with material contractual obligations and his awareness that such failure was not acceptable to the employer.

Dismissal with notice can validly be made for a number of reasons, including repeated late arrivals, disobedience, harassment, competing activities or other acts of disloyalty, negligence in performance, and acts subject to criminal liability. However, dismissal with notice is the last resort for the employer, and cannot validly be made unless the employer has given the employee a reasonable chance to improve and also exhausted the possibilities to transfer the employee to another position. Dismissal without notice is reserved for severe breaches of the obligations under the employment contract, such as wilful and repeated disobedience of orders, criminal acts directed against the employer, and other acts involving a serious breach of material responsibilities under the employment contract.

## • **Holidays**

According to the Swedish Holidays Act (1977:480), the minimum general holiday entitlement is twenty-five days' holiday in each twelve-month period from April 1 to March 31 ("holiday year"). Unless otherwise agreed, the employee is normally entitled to exercise four weeks of holiday during the period June – August. The employee's mandatory right to holiday pay is assessed on a pro-rata basis corresponding to the part of the preceding holiday year ("earning year"), that the employee was employed by the employer. The employee may save part of his paid holiday entitlement for a period of up to five years.

## • **Working time**

In Sweden, working time is mainly governed by the Swedish Working Time Act (1982:673). The ordinary working time is limited at forty hours per week. The requirements under the Act are mandatory, but may be overruled by a central collective agreement concluded by a central trade union and to a limited extent also by a local collective agreement. Save for a limited number of specific employees, mainly managing executives and uncontrolled employees, the Act applies to all work except work performed at sea (seamen) and in the employer's household, which is subject to separate legislation.

## • Sick pay

Under the Sick Pay Act (1991:1047), the employer has to pay eighty per cent of the employee's salary and benefits during the first 14 days of a sick leave, save for a one day qualification period. If the sickness period exceeds 14 days, sickness allowance is payable to the employee under the National Social Insurance System. The employer is in such cases obligated to pay a fee to the National Social Insurance System corresponding to fifteen per cent of the employee's benefit. Under many collective agreements employees are entitled to more favourable terms and conditions in relation to sick pay and to supplemental sickness allowance.

## • Parental leave

Under the Parental Leave Act (1995:684) parents with children below the age of one and a half year are entitled to full parental leave. The employee also has the right to reduce the working time by twenty-five per cent until the child is eight years old. In addition, parents are entitled to parental leave during such time they receive parental benefits from the National Social Insurance System. Such benefits are paid to the parents during 480 days. For children born after the 1 of January 2014 such benefits may be payed until the age of twelve. Regarding children born before that date, such benefits are payed until the child reaches the age of eight. In principle, the parents decide themselves who will exercise such parental benefits, but 90 days are reserved for each parent. Fathers may take an additional 10 days of leave in connection with the birth.

## • Board representation

Employees in limited companies and co-operative associations having at least 25 employees are entitled to appoint two board members and two deputy members to the board of directors. Such board members are appointed by the trade unions.

- **Confidentiality**

In Sweden, trade secrets are primarily protected by the provisions of the Swedish Trade Secrets Protection Act (1990:409). Under this Act, the provisions protecting trade secrets from being disclosed by employees are in principle limited to the duration of the employment. Subsequent to the termination of the employment, only very severe breaches of the Act may result in a liability to pay damages for the employee. However, there are in principle no legal restrictions in terms of the enforceability of imposing wider obligations on confidentiality on the employee by mutual agreement, unless such restrictions are provided for in a collective agreement to which the employer is bound.

- **Non-discrimination rules**

The Anti-discrimination law (2008:567) intends to promote equal rights for women and men regarding employment, conditions of employment and other conditions of work and also to provide opportunities for personal development in employment. The rights of ethnic minorities are also governed by the law. Furthermore, the law prohibits discrimination in the labour market of the disabled persons as well as discrimination based on sexual orientation, gender, ethnicity, religion and age. Generally, the non-discrimination legislation applies to employees, but also to the entire recruitment procedure, implying that refused applicants may seek relief even if the recruitment procedure does not result in a decision to hire.

- **Health and safety**

The Working Environment Act (1977:1160) contains the basic provisions concerning occupational safety and health matters in Sweden. Moreover, the Act includes regulations on how employers and employees should co-operate on work environmental matters. The working environment in principal comprises all conditions at work places. The Act applies to the physical safety of employees but also to mental and psychological work conditions at workplaces generally. According to the Act, the responsibility for the working environment primarily rests with the employer. The employer is also responsible for rehabilitation of employees and continuous improvements of the working conditions.

## • Types of ownership

Swedish land is divided into property units. Ownership of land is always connected to a registered property unit. A property unit can be demarcated horizontally as well as vertically thereby creating three-dimensional property units. Absolute ownership of a property unit entails the right to own, occupy and dispose of the property unit. Where a right less than absolute ownership is intended, a right to site leasehold may be granted. Real estate may also be owned by a tenant-owner association (Sw. Bostadsrättsförening) or a co-operative lease association (Sw: Kooperativ hyresrättsförening).

A right to a site leasehold (Sw. tomträtt) may only be granted over publicly owned land. The site leaseholder essentially has the same legal status as an owner of land, thus he has the exclusive right to use and occupy the property (but he has no right to sell the land). A right to site leasehold is generally granted for an indefinite period in return for an annual fee, normally calculated as a percentage (equalling the long term interest rate less inflation) of the land value.

When a tenant-owner association purchases a property unit the association becomes owner of the real property. The members of the association acquire shares in the association's capital, corresponding to their designated units (usually flats) which they have an exclusive right to use without any limitation in time as long as they pay a monthly fee to the association to cover the running expenses of the building and the association's interest cost where applicable. The acquirer of the equity share in the association must be granted membership of the association in order for the purchase to be valid. A tenant-owner association can be formed not only for residential purposes but also where a building is used for commercial purposes or is used for a mix of residential and commercial purposes.

An association similar to the tenant-owner association is the so called co-operative lease association. It is an economic association formed for the purpose to lease residential apartments to its members. Every member of the association has to pay a member fee and the association can also require its members to pay special fees. If the lease period is terminated the members only have a right to regain paid fees. The association's profit can only be divided between the members and is generally divided between them in relation to their contributions.

In 2009 a new type of housing was made possible in Sweden using three-dimensional real estate. These so-called ownership apartments (Sw. *ägarlägenheter*) gives the owner a possibility to own their own apartment in an apartment building. Ownership apartments mean greater autonomy because you own the apartment and you can register it under the same rules as for other types of property. In addition, no tenant-owner association must approve purchases or subleasing. The owner of the apartment may freely pledge, encumber or dispose of their three-dimensional property.

- **Land Registry**

All property units are registered in the Land Registry (Sw. *Fastighetsregister*) which is computer-based. The Land Registry is administered by the Land Registration Authority (Sw. *Fastighetsinskrivningen*) which is part of the Swedish National Land Survey (Sw. *Lantmäteriet*). The Swedish National Land Survey maintains seven regional branches in Sweden.

All registered property units have specific names and codes, normally consisting of the name of the municipality or city where the property is situated, an area name and numbers for local identification. The Land Registry contains information for every property unit including the location of the property, the registered owner (and the registered leaseholder where applicable), mortgages easements, tax assessment values and the most recent transfer, including the purchase price. The records and documents submitted to the Land Registry are public and anyone can request an extract from the registers (certificates of searches) (Sw. *Gravationsbevis*). The registers provide useful information and are regularly used in the process of transferring property. Detailed maps of the real property can be provided by the Swedish National Land Survey.

- **Transfer**

Normally the parties will use two contractual documents for the transfer of real property in Sweden. The first document is a purchase agreement (Sw. *Köpekontrakt*) including all conditions, warranties etc. The second document, which is normally drawn up on the day of the actual transfer of property to the purchaser, is the Bill of Sale (Sw. *Köpebrev*). The Bill of sale confirms that the purchase price has been paid etc. The formal requirements for a transfer of real property to be valid according to the Swedish Land Code (Sw. *Jordabalken*) are relatively simple. Firstly, the purchase agreement must be in writing and be signed by both the seller and the purchaser. Secondly, the agreement must include information about the

purchase price and the name and code of the property unit. Thirdly, the agreement must contain a declaration that the seller conveys the property to the purchaser. Finally, if the seller has any spouse or co-habitee their approval is also required. As regards witnesses, it is not an absolute requirement to have them but the absence of witnesses when it comes to the seller's signature may cause a delay in the registration procedure. It is also important to be aware of that a written or oral option to purchase or sell real property is not valid.

Although a registration of ownership in the Land Registry is not necessary for a valid transfer of ownership, it is important that an application is filed at the Land Registry within three months from the acquisition of the property. Normally the Bill of Sale is then also submitted to the Land Registry and thereby made public. When the ownership is registered in the Land Registry, the Land Registration Authority issues a certificate of title to the owner. The registered owner has the formal capacity to take action involving the property and will be regarded as the owner in relation to authorities. A registered owner may also mortgage the property and agree on other rights over the property (e.g. rights of use and enjoyment). Furthermore, if a property has been sold twice by the same seller, the first purchaser to apply for registration of ownership normally has priority over the other purchaser. The relevant tax applied on a purchase of real property is stamp duty (explained below).

## • Mortgages

Swedish banks are in general very reluctant to grant loans for real property investments without any security in the property. In practise mortgage is the only recognised formal fixed security taken over property in Sweden. The formal capacity to mortgage a property belongs to the registered owner of that property unit. If the owner is an individual and is married or co-habitant, written consent from the spouse/co-habitee is required. To mortgage the property unit an application has to be filed at the Land Registration Authority. The registered owner thereafter receives a mortgage certificate (Sw. *pantbrev*) with the value specified and the certificate is registered in the Land Registry. As regards the total face value of the mortgage certificates that may be registered and issued there is no limit. However, the practical value of all the mortgage certificate issued is naturally limited to the value of the property. For issuing the certificate a stamp duty at a rate of two per cent of the face value of the mortgage certificate is charged. No extra stamp duty is levied when the mortgage certificate is used as security for a liability.

When the mortgage certificate is delivered to the creditor for the purpose of constituting security for a debt or some other obligation, the security is perfected. If part of the amount of the mortgage certificate is not needed to cover the debt,

the excess amount may be used as second ranking collateral for some other debt or obligation. In the case of a second mortgage as described above, a notice to the holder of the mortgage certificate is needed for the security to be perfected. Until the loan is settled the creditor's lien and the mortgage right exists. When the loan is settled, the mortgage certificate should be handed back to the owner, who may then use the same mortgage certificate as security for a new loan or any other liability without additional stamp duty or costs.

Now a day, however, its more common to use electronical mortgage certificates. These corresponds to the physical possession of a mortgage letter. The Land Registry shows that the certificate is electronic. It also holds information about who is the recipient of the electronic mortgage letter.

## • Restrictions on Acquisitions

There are no restrictions on foreign ownership of real property in Sweden. However, there are some legal restrictions imposed regarding the transfer of property in general. The pre-emption act expired at the end of April 2010. It allowed Swedish municipality's pre-emption rights when real property (or a right to site-leasehold) were sold. However, the municipality's pre-emption right still applies to sales of real property, if the municipality registered the property in the Land Registry before the first of May 2010.

Act on Acquisitions of Apartment Property etc was in force until 2010 (Sw: Lagen om förvärv av hyresfastighet). According to the law transfers of properties taxed as rental housing units did not in general require authority approval. However, it was obligatory to notify the municipality of an agreement on transfer of such properties (and the site leasehold right to such properties) within three months from entering into the agreement. One of the purposes of notifying the municipality was to protect the existing tenant's interests when there rental housing unit were sold. To maintain the purposes of the act, stricter rules were introduced in another act called The Act on Housing Administration.

According to the Agricultural Land Acquisition Act (Sw: Jordförvärvslagen) transfers of land taxed as agricultural property require approval by the County Administrative Board (Sw: Länsstyrelsen) if the property is situated in designated parts of Sweden or the acquirer is a legal entity and the property is purchased from an individual or the estate of a deceased person. Approval is required also when agricultural property is transferred by a contribution in kind to a company or as a dividend from a company. If the land is purchased at a compulsory auction no approval is needed. For a legal entity approval is normally given only in very special situations.

## • Restrictions on Development

The main act in Sweden on the regulation of the use of land is the Planning and Building Act, (“PBA”), (Sw. *Plan- och bygglagen*). According to the PBA each municipality in Sweden must adopt plans regulating the utilisation of land and water within the municipality. The plans to be adopted are comprehensive plans (Sw. *Översiktsplan*), regional plans (Sw. *Regionplan*) and detail plans (Sw. *Detaljplan*). A detail plan applies to a limited part of the municipality (normally a few blocks in a town) and is binding on the authorities as well as individuals during the time it is to be achieved. The plan includes regulations concerning the use of the land and construction work on the land.

Before construction work is started a building permit (Sw. *Bygglöv*) is required and an application therefore must be sent to the local building committee (Sw. *Byggnadsnämnden*). Which activities on or changes of buildings and property that require building permits are regulated in the PBA in detail. As regards activities including erecting, altering, and extending of buildings or amended use of a building or part thereof, permits are compulsory. If the development project adheres to the detail plan and construction standards the property owner will in general be entitled to the building permit. If the building permit is denied by the local building committee, the decision can be appealed to the County Administrative Board (Sw. *Länsstyrelsen*). The local building committee can also issue a preliminary statement on whether a building or an installation that requires a building permit may be permitted on the intended site. The PBA also contains provisions with respect to demolition permits and permits regarding ground works. In addition to the PBA it should also be mentioned that the Environmental Code (Sw. *Miljöbalken*) regulates planning on a national level in order to economise with natural resources such as forests and running water.

## • Leases

Leases can be granted either for residential or commercial purposes. The regulations on commercial and residential leases vary in important areas and the legal provisions are to a great extent mandatory in favour of the tenant. The below overview concentrates on different aspects on commercial leases. There is no requirement of a certain form for entering into a legally binding lease agreement. However, almost all lease agreements are in written form. Often when letting commercial premises, a rather simple standard contract form is used. The standard form has been drawn up and negotiated between the Swedish Property Federation in co-operation with the Swedish Federation of Trade and the Swedish Hotels- and Restaurants Association. However, it is common that the parties agree on specific



provisions attached to the standard agreement. The term of lease can be fixed or continuous. Usually, leases are granted for a fixed period between three to five years. There are, however, many examples of both shorter and longer lease periods. In towns and cities the maximum term of lease is 25 years, but on the countryside a lease period of up to 50 years is allowed. There are no restrictions regarding the minimum term of the lease.

The rent has to be a fixed sum, but for commercial properties the parties may freely agree on the amount of this sum. It is very common that commercial tenants pay added charges for heating, cooling, water and property tax. Commercial premises are sometimes let on a turnover basis, and the rent is determined as a percentage of the income generated by the tenant. Normally the tenant has to pay the rent in advance and in quarterly instalments. It is also quite common that the rent is linked to changes in the consumer price index from year to year. However, such indexation is not allowed if the lease period is shorter than three years.

A tenant's main obligations are to pay the rent, use the premises only for agreed purpose, to take good care of the premises and not disturb its neighbours. The parties are free to agree on responsibility and the duty to pay for maintenance of the premises. As regards commercial leases it is not unusual that the majority of the costs for maintenance and utilities of the premises are borne by the tenant. The landlord's main obligations are to provide premises fit for the intended purpose/use and to repair defects cause by ordinary wear and tear.

Unless the landlord has very strong reasons for not extending a lease after the expiration of the agreed lease period the commercial tenant is entitled to compensation for his loss (Sw. *Indirekt besittningsskydd*). The right to compensation ceases if the landlord offers the tenant an extension of the lease on market terms and the tenant does not accept those terms. The right to compensation is also waived if the tenant does not submit the matter to the Regional Rent Tribunal within two months from the date he received the notice for termination. A tenant may also in advance waive his right to extension or compensation in a separate document. If the lease has been in force less than nine months at the time for signing the waiver, an approval from the Rent Tribunal might be necessary for the waiver to be valid. In general, a tenant has no right to transfer a lease agreement without the consent of the landlord. However, one important restriction of the rights of the landlord is that the Rent Tribunal may, subject to certain conditions, authorise the tenant to transfer his tenancy to a person who is taking over the trade or business carried on by the tenant on the premises.

## • Stamp Duty

The relevant tax in case of purchases of real property (and leasehold rights) is stamp duty. Stamp duty falls due when the purchaser's title to the property is registered in the Land Registry (however special regulations apply when a real property is sold within a group of companies). Stamp duty is also triggered when real property (or a leasehold right) is transferred as a contribution in kind to a company and when real property is distributed as a dividend in kind from a company. Normally the stamp duty is paid by the purchaser, but if the purchaser does not pay, the seller is liable for it. The stamp duty is either based on the purchase price (or the value of the real property) or the tax assessment value of the property for the year before the registration of ownership, whichever is the higher. The stamp duty rate triggered for transfers in case the purchaser is an individual or a tenant-owner association is 1.5 percent of the value, and in case the purchaser is a legal entity, 4.25 per cent of the value.

Stamp duty is also triggered when a mortgage certificate is issued by the Land Registration Authority. The stamp duty on a mortgage certificate is 2 per cent off the face value of the certificate. As regards rent or lease agreements no stamp duty is triggered.

## • VAT

Transfers or letting of property does not trigger value added tax ("VAT") (Sw. *mervärdesskatt, abbr. moms*) However, the owner of a business property may voluntarily choose to have premises, in which commercial activities are carried out, registered for VAT (provided that the tenant is liable for VAT). The registration can also be applied for by a tenant or a sub-tenant involved in commercial activities on the premises. As long as the premises are registered for VAT, the owner can charge VAT on the rent and offset it against VAT paid by him on maintenance, repairs and other expenses as well as building costs.

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# Bağ & Günen

# Law Firm

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Turkey

#### 📍 Head Office

Barbaros mah. Kardelen sok.  
Palladium Tower No:2 Kat:10  
Ataşehir İstanbul 34888

☎ +90 216 687 08 72

☎ +90 216 687 03 03

[www.engblaw.com](http://www.engblaw.com)

#### General information

Bağ & Günen Law Firm is a boutique law firm based in Istanbul.

We are focused on providing all aspects of business law that may be required by domestic and foreign clients from market entry to exit and all our services are tailored as per the needs of each client.

We are committed to offer practical, methodical, swift solutions to our clients' legal problems and ensure that their needs are answered in an efficient and qualified manner.

Our client portfolio includes small and medium-sized companies, start-ups together with international corporations operating within markets such as construction, telecommunication, food & agriculture, energy, technology and we also provide consultancy to leading Turkish associations and foundations.

#### Areas of participation

Bağ & Günen Law Firm provides legal services within most areas of commercial & corporate law, but our primary practice areas are as detailed below:

- Trademark, Patent and IP
- International Trade Law
- Energy
- Administrative law
- Data Protection, Privacy
- Debt Collection and Litigation
- Company incorporation
- M&A,
- Employment & Labour
- Real Estate
- Insurance
- Maritime & Marine
- Consumer and E-Commerce

# Turkey | CORPORATE LAW

Turkey is a civil law country and the Turkish Commercial Code no. 6102 was enacted in 2012 for repealing the previous code to align with the related developments in the international legal scene including EU *acquis communautaire*. Within this scope, many important amendments were introduced particularly in the corporate governance area to increase transparency and ensure accountability, fairness and responsibility in corporations.

Pursuant to the Turkish Commercial Code (“TCC”), the corporations consist of collective company, commandite company, ordinary partnership, cooperative company<sup>1</sup>, joint stock company and limited liability company under Turkish law. Within the scope of the TCC, collective and commandite company are deemed as partnerships whereas joint stock, limited liability and commandite company limited by the shares are deemed as corporations in which the liability is limited to the value of the share capital.

In practice, limited liability and joint stock companies are generally preferred by medium and large-sized companies and by foreign investors. Also, some sectors such as banking, energy require incorporation of a joint stock or limited liability company for obtaining the relevant licenses, permits, etc. On the other hand, many small business owners operate via partnership models.

The two tables below illustrate the most common entity types, and list the most relevant characteristics of each type. Table 1 describes types of corporations and Table 2 describes partnerships. Each type of entity is further described below the tables together with branch and liaison office.

<sup>1</sup> Pursuant to the TCC, cooperative companies are deemed as a business corporation, however they are regulated by the Law on Cooperatives no. 1163. They are established by at least 7 shareholders which can be real or legal persons. A permit is required to be obtained from the Ministry of Customs and Trade for incorporation.

<b>TABLE 1</b>	<b>JSC</b> (Joint Stock Company)	<b>LLC</b> (Limited Liability Company)	<b>Comm LLC</b> (Commandite Company Limited by the Shares)
<b>Use</b>	Middle-sized and large companies (may be listed on the stock exchange, though this is not mandatory)	Small and middle-sized companies	Small and middle-sized companies (at least five incorporators and one of the incorporators should be a real person as an unlimited partner)  The difference between the general commandite company is that the Comm. LLC's capital is divided by shares which can be transferred freely similar to a joint stock company
<b>Minimum capital requirement</b>	TL 50,000 (only 25 % of the total capital should be deposited initially)  TL 100,000 for non-public joint stock companies which accepted the registered capital system	TL 10,000 (only 25 % of the total capital should be deposited initially)	No minimum requirement
<b>Liability</b>	Shareholder's liability is limited to the value of the share capital	Shareholder's liability is limited to the value of the share capital	The unlimited partners have an unlimited, joint and several (secondary) liability.  The liability is limited to the value of the share capital for limited partners
<b>Management</b>	A Board of Directors with one or more members which are appointed by the articles of association or the general meeting	A General Manager which is appointed by the articles of association. At least one shareholder should be appointed as manager	Management is regulated by the unlimited partner
<b>Change in articles of association</b>	Depends on what is agreed in the articles of association. If nothing is agreed: in general majority of the submitted votes <u>and</u> at least 1/2 of the share capital represented on the general meeting is necessary.  Some extensive changes require a higher share of votes	Depends on what is agreed in the articles of association. If nothing is agreed: simple majority of the submitted votes <u>and</u> 2/3 of the share capital represented on the general meeting.  Some extensive changes require a higher share of votes	Depends on what is agreed in the articles of association. If nothing is agreed: in general majority of the submitted votes <u>and</u> at least 1/2 of the share capital represented on the general meeting.  Some extensive changes require a higher share of votes

<b>Share classes</b>	<p>Different classes (A-, B-, C- etc.) can be created via articles of association or amendment of articles of association.</p> <p>In terms of privileged shares, one class can be given a higher voting right up to 15 votes for each share which cannot be used for certain resolutions</p>	<p>Different classes (A-, B-, C- etc.) can be created via articles of association or amendment of articles of association.</p> <p>Privileged shares can be created with voting rights such as one vote for each share capital apart from its par value.</p>	<p>Different classes (A-, B-, C- etc.) can be created via articles of association or amendment of articles of association.</p> <p>In terms of privileged shares, one class can be given a higher voting right up to 15 votes for each share which cannot be used for certain resolutions</p>
<b>Shareholders agreement</b>	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties	Valid inter partes but cannot override mandatory corporate law. Not valid against third parties
<b>Accounting</b>	<p>Financial tables of the company and annual activity report of the Board is required to be audited as per the Turkish auditing standards which is compatible with the international standards.</p> <p>Commercial books should be kept as per the relevant articles of the TCC</p>	<p>Financial tables of the company and annual activity report of the manager(s) is required to be audited as per the Turkish auditing standards which is compatible with the international standards.</p> <p>Commercial books should be kept as per the relevant articles of the TCC</p>	<p>Financial tables of the company and annual activity report is required to be audited as per the Turkish auditing standards which is compatible with the international standards.</p> <p>Commercial books should be kept as per the relevant articles of the TCC</p>
<b>Company tax</b>	Corporate tax 20%	Corporate tax 20%	Corporate tax 20%
<b>Tax on capital gains</b>	Capital gains derived by a company generally are taxable as ordinary income (15%). However, 75% of capital gains derived from the sale of domestic participations are exempt from corporation tax subject to certain conditions which include sale of properties and transfer of shares	Capital gains derived by a company generally are taxable as ordinary income (15%). However, 75% of capital gains derived from the sale of domestic participations are exempt from corporation tax subject to certain conditions which include sale of properties and transfer of shares	Capital gains derived by a company generally are taxable as ordinary income (15%). However, 75% of capital gains derived from the sale of domestic participations are exempt from corporation tax subject to certain conditions which include sale of properties and transfer of shares
<b>Registration</b>	Must be registered with the relevant trade registry	Must be registered with the relevant trade registry	Must be registered with the relevant trade registry
<b>Legislation</b>	TCC	TCC	TCC



<b>TABLE 2</b>	<b>Coll</b> (Collective Company)	<b>Comm</b> (Commandite Company)	<b>Ordinary Partnership</b>
<b>Use</b>	Small companies (at least two owners who are private persons)	Small and medium companies (at least two owners, one limited partner and one unlimited partner which can be a private or legal person)	Used generally for purposes such as joint venture projects, consortiums. (at least two owners who are legal and/or real persons)
<b>Minimum capital requirement</b>	No minimum requirement	No minimum requirement. (The limited partner may only invest capital as cash or goods or rights that can be converted to cash)	No minimum requirement (Unless agreed otherwise via articles of association share capital of owners should be equal)
<b>Liability</b>	The partners have an unlimited, joint and several (secondary) liability.	Liability is limited to the value of the share capital for the limited partner. Unlimited, joint and several liability for the unlimited partner.	The partnership has no legal personality. Therefore the owners have an unlimited, joint and several liability.
<b>Management</b>	Unless agreed otherwise in the articles of association or by a decision of the partners (absolute majority) each partner can legally enter into binding obligations on behalf of the collective company	Management is regulated by the unlimited partner(s). The limited partners cannot object to the actions of the limited partners which are intra vires	Each of the owners have management rights unless it is agreed otherwise in the articles of association or via a decision. The management rights may be assigned to one of the owners or a third party
<b>Change in articles of association</b>	Changes should be approved unanimously by the partners	Changes should be approved unanimously by the partnership	Changes to the partnership agreement should be approved unanimously by the partners
<b>Share classes</b>	Each partner has one voting right which cannot be amended via articles of association	Each partner has one voting right which cannot be amended via articles of association	No share classes
<b>Shareholders agreement</b>	Valid inter partes but cannot override mandatory provisions of law of obligations. Not valid against third parties	Valid inter partes but cannot override provisions of law of obligations. Not valid against third parties. The relationship between the limited and unlimited partners are required to be regulated by the articles of association	No shareholders agreement

<b>Accounting</b>	Commercial books should be kept as per the relevant articles of the TCC. The financial statements shall be finalized upon majority approval by the board of partners.	Commercial books should be kept as per the relevant articles of the TCC. The financial statements shall be finalized upon majority approval by the board of partners.	Commercial books should be kept as per the relevant tax legislation.
<b>Company tax</b>	Collective company has no legal personality in terms of corporate income tax except for taxes such as VAT, Special Consumption Tax, withholding, etc. All other business income is taxed as personal income.  Personal income tax rate differs between 15 %- 35%	Commandite company has no legal personality in terms of corporate income tax except for taxes such as VAT, Special Consumption Tax, withholding, etc. All other business income is taxed as personal income for both limited and unlimited partners.  Personal income tax rate differs between 15 %- 35%	Ordinary partnership has no legal personality in terms of corporate tax except for taxes such as VAT, Special Consumption Tax, withholding, etc. All other business income is taxed as income for owners depending on their legal personality
<b>Tax on capital gains</b>	Personal income tax 15%	Personal income tax 15%	Personal income tax rate differs between 15 %- 35%
<b>Registration</b>	Must be registered with the relevant trade registry. The articles of association are also required to be submitted	Must be registered with the relevant trade registry. The articles of association are also required to be submitted	No requirements
<b>Legislation</b>	TCC	TCC	Turkish Code of Obligations

## • Choice of legal entity

Before starting a business the preferred type of legal entity must be considered. The choice can depend on many different factors but the most common factors are one or more of the following:

- Liability
- Taxation of the company and the owners
- Sufficiency of establishing a branch (foreign companies only)
- Start-up capital and running costs (share capital, registration costs etc.)
- Overall reputation in the market
- Company's area of operation (whether incorporating a certain type of entity is required or not)

## • Types of companies

As earlier mentioned there are several different types of legal entities. The types most commonly chosen for medium-sized and large companies are either a joint stock company (JSC) or a limited liability company (LLC). These two types of company are regulated by similar provisions and their shareholders' liability is both limited to the subscribed share capital but they differ in some aspects, as described below:

### **JSC (JOINT STOCK COMPANY)**

Most large companies in Turkey (and all stock-exchange listed companies) are established as a JSC, which is a well-reputed entity type. The total required share capital is minimum TL 50,000, at least 25 % of the total share capital shall be paid before the registration and the remaining amount is required to be paid within 24 months from the registration. A JSC may be incorporated with a single shareholder and there is no limit for maximum number of shareholders.

In terms of foreign shareholding, there are no restrictions apart from certain regulated sectors. On the other hand, a permit and/or license should be obtained from the relevant Ministry for starting commercial activities regardless of the shareholder's nationality if the company will operate in some sectors such as banking, insurance, financial leasing.

A JSC must have a Board of Directors with one or more members which should be appointed by the articles of association or a resolution of the shareholders. A legal person may also be appointed as a member. The articles of association may include certain provisions for providing the right of representation in the Board for certain shareholder groups and the minority shareholders. The Board may establish committees and commissions which may include a Board member for purposes such as monitoring the business, reporting and internal auditing. The management may be assigned partially or fully to one or more members or a third person by the Board of Directors via a provision in the articles of association.

The ordinary general meeting shall convene within three months as of the end of each activity period. Unless it is agreed otherwise within the articles of association or required by the TCC, the general meeting shall convene with shareholders re-

presenting at least  $\frac{1}{4}$  of the share capital and simple majority voting will be enough. For amendments of articles of association different voting and quorum requirements will apply. If there is a related provision within the articles of association, a shareholder may attend and vote in a general meeting via electronic mediums.

A JSC pays 20 % in corporate taxes based on the company's yearly profit. The shareholders' return on shares are exempt from corporate income tax if the shareholder is a legal person, it will be subject to a 15 % personal income tax for real person shareholders. The company will be subject to independent auditing if certain criteria are met such as total number of employees, annual net sales revenue.

#### **LLC (LIMITED LIABILITY COMPANY)**

Many small and middle-sized companies choose to run their business as a LLC, which requires a share capital of TL 10,000, at least 25 % of the total share capital shall be paid before the registration and the remaining amount is required to be paid within 24 months from the registration. The shareholders' liability is limited to their investment in shares. An LLC can be established by a single shareholder, the maximum number of shareholders for LLC is determined as 50.

An LLC must have one or more managers and they shall be appointed by the articles of association. At least one of the shareholders is required to be appointed as a manager. If there is more than one manager, a Board of Managers shall be convened. The ordinary general meeting shall convene within three months as of the end of each activity period. Unless it is agreed otherwise within the articles of association all resolutions shall pass by a simple majority of the represented share capital. Some matters such as increasing the share capital require at least  $\frac{2}{3}$  of the represented votes and the simple majority of the share capital with voting right to be present.

A LLC pays 20 % in corporate taxes based on the company's yearly profit. The shareholders' return on shares are exempt from corporate income tax if the shareholder is a legal person, it will be subject to a 15 % personal income tax for real person shareholders. The company will be subject to independent auditing if certain criteria are met such as total number of employees, annual net sales revenue.

The lower amount of required share capital makes this entity type very attractive to founders who either cannot or will not tie up more capital than necessary, but still wish to limit their liability risks.

**JSC (JOINT STOCK COMPANY) VS. LLC ( LIMITED LIABILITY COMPANY)**

A JSC and a LLC are subject to similar provisions but differs mainly concerning the following conditions:

	<b>JSC</b>	<b>LLC</b>
<b>Minimum share capital</b>	TL 50,000 (only 25 % has to be deposited)	TL 10,000 (only 25 % has to be deposited)
<b>Shares for public subscription</b> (e.g. on a stock exchange)	Yes	No
<b>Management</b>	Board of Directors + Managers	General Manager
<b>Liability for Public Debts</b>	Yes	No
<b>Share Transfer</b>	Easily made	Must be approved by a general meeting

**COMM. LLC (COMMANDITE COMPANY LIMITED BY THE SHARES)**

A Comm. LLC is a hybrid between a Joint Stock Company and a Commandite Company. There is no minimum capital requirement for incorporation. As at least five incorporators are required and the unlimited partner (shareholder) has an unlimited, joint and several (secondary) liability it is not generally preferred.

The provisions of the TCC for regulating commandite companies are applied in terms of relationship between the limited partners, unlimited partners and third parties, the unlimited partners' management and representation rights. The liability of the limited partners is limited to the value of their share capital.

The unlimited partners are responsible for management and representation of the company. A Comm. LLC pays 20 % in corporate taxes based on the company's yearly profit. The shareholders' return on shares are exempt from corporate income tax if the shareholder is a legal person, it will be subject to a 15 % personal income tax for real person shareholders.

The company will be subject to independent auditing if certain criteria are met such as total number of employees, annual net sales revenue.

## COLLECTIVE COMPANY

Collective companies are preferred by real persons that know and trust each other since the partners have an unlimited, joint and several (secondary) liability. The liability of the partners shall arise in case debt enforcement proceedings are unsuccessful against the company or the company ceased to exist for any reason.

At least two real persons are required for incorporating a collective company. Each partner shall have a right to manage the company however the management may be assigned to one or more or all the partners by a simple majority decision. Each partner has a single right to vote which cannot be amended by articles of association or another contract.

The collective company has no corporate tax liability and therefore the company's yearly profit shall be subject to personal income tax after division among the partners as per their share rates. The personal income tax differs between 15%-35%.

## COMMANDITE COMPANY

Commandite companies are generally incorporated by legal entities intending to partner with a real person for a certain business or a project whilst still benefitting from limited shareholder liability.

There are two types of partners in a commandite company, the unlimited (koman-dite) and limited partner (komandit) and for incorporation at least one limited and one unlimited partner is required. The unlimited partner may only be a legal person and the limited partner may only be a real person. The articles of association are reviewed primarily for determining whether the company satisfies the conditions for being a commandite company or not. If not the company will be deemed as a collective company. Each partner has a single right to vote which cannot be amended by a contract. The commandite company is managed by the unlimited partner. The limited partners can vote for certain matters such as extraordinary proceedings and business, amendment of the articles of association, for structural changes like changing the type of entity and transfer of shares, etc. The liability of the limited partner is limited with the share capital deposited or undertaken by itself except for certain exceptions determined by the TCC. If the company's assets will not be sufficient for its debt, the unlimited partners shall have an unlimited, joint and several (secondary) liability.

The commandite company has no corporate tax liability and therefore the company's yearly profit shall be subject to personal income tax after division among the partners as per their share rates. The personal income tax differs between 15%-35% for unlimited partners and will be 15% for limited partners.

**COLLECTIVE COMPANY VS. COMMANDITE COMPANY**

A collective company and a commandite company are subject to similar or same provisions but differs mainly concerning the following conditions:

	<b>Coll</b>	<b>Comm</b>
<b>Management</b>	Each partner	Unlimited partner
<b>Liability</b>	Partners have an unlimited, joint and several liability	Unlimited partner's liability is limited
<b>Owner</b>	Two real person	One real and one legal person

**ORDINARY PARTNERSHIP**

In general, ordinary partnership is generally used for projects, investments in order create joint ventures, consortiums. Unlike the corporations, ordinary partnerships are regulated by the Turkish Code of Obligations numbered 6098. An ordinary partnership is created via a partnership agreement by two or more real and/or legal persons. Each partner must provide a contribution which may be cash, goods, know-how, skills, etc., and the contribution of each partner shall be equal unless it is stated otherwise within the contract. Similarly each partner has equal shares in the profit of the partnership. The decisions of the partnership shall be taken unanimously unless it is determined otherwise within the partnership agreement.

Each partner has a right to manage the partnership, on the other hand the management may be assigned to one or more partner or a third party via the partnership contract or a decision. Under Turkish corporate law the partnership has no legal personality. Therefore, the owners have an unlimited, joint and several liability.

The ordinary partnership has no corporate tax liability and therefore all revenues shall be taxed as per the legal personality of the owners. Under certain conditions the ordinary partnership may be accepted as a joint venture as per the relevant provisions of the Corporate Tax Law and thereby will be taxable in terms of corporate tax legislation.

## BRANCH

A foreign company can establish a branch in Turkey by registering to the relevant trade registry by submitting the necessary documentation. In addition to registration, a fully authorized commercial representative should be appointed.

The branch is taxed in terms of corporate tax legislation which is 15%. If it is a branch of a foreign company, the commercial name should indicate the registered office of the company and the place(s) of branch and that it is a branch.

## LIAISON OFFICE

Liaison offices are generally preferred by foreign companies wishing to enter the market to gather information, undertake research and establish connections since liaison offices are prohibited from undertaking commercial activities.

Liaison offices are regulated by the Foreign Direct Investment Law no. 4875. As per the Regulation on the Implementation of the Law, a liaison office may be incorporated by foreign companies in Turkey via obtaining an establishment permit from the Ministry of Economy provided that the necessary documents are submitted duly. The initial establishment permit may be up to three years which may be extended upon expiration up to three years.

A liaison office may conduct the following activities in general, representation and hosting; control, inspection and provision of local suppliers; technical support; communication and transfer of information; regional management headquarter. The Ministry evaluates the liaison office establishment permit applications of newly established foreign companies within the context of some elements such as the field of activity, the capital and the number of personnel employed and may stipulate the condition for the company to have been operational for at least one year in order to grant the permit.

Liaison offices, are required to send a copy of the tax office registration and the rental contract to the relevant General Directorate within one month upon obtaining the establishment permit. Since the liaison office is prohibited from entering commercial activities, it shall have no tax liability. Within this scope, any and all office expenses have to be covered by the foreign exchange imported from abroad.



## • The Trade Registry and Incorporation Procedures

The Trade Registries are responsible for registration of companies and keeping the related records. They are set up in various cities of Turkey and registration application is made to the relevant registry as per the intended address of the company.

All companies are required to make a registration application to the Trade Registry as per the related provisions of the TCC.

The records of the registry are public and thereby they can be reviewed upon application or via the related registry's website.

All necessary documents including the articles of association are required to be submitted for incorporation application. Apart from the articles of association, incorporation documentation that will be issued and executed outside Turkey must be notarized and apostilled or alternatively ratified by the Turkish consulate where they are issued. The original executed, notarized, and apostilled documents must be officially translated and notarized by a Turkish notary.

# Turkey | TAX LAW

Turkey has one of the most competitive corporate tax rates in the OECD region and the Turkish tax regime may be classified under three headings as follows:

## • Income tax

The Turkish tax legislation includes two main income taxes, namely individual income tax and corporate income tax. Individual income tax is governed by the Personal Income Tax Law (PIT Law) no. 163 and the corporate income tax is governed by the Corporate Income Tax Law (CIT Law) no.5520.

### INDIVIDUAL INCOME TAX

Pursuant to the PIT Law, the real persons' income is subject to individual income tax. Income is defined as the net amount of all earnings and revenues derived by an individual within a single calendar year. Partnerships are not deemed to be separate entities and each partner is taxed individually on his/her share of profit.

For determining tax liability for residency criterion is applied which is subject to certain exceptions. Within this scope, an individual whose domicile is in Turkey is liable to pay tax for his/her worldwide income (unlimited liability). In addition, any person who resides in Turkey more than six months in one calendar year is also deemed as a resident of Turkey.

In terms of foreigners, any foreigner who stays in Turkey for six months or more for a specific job or business or particular business which are specified in the Law on Income Tax are not treated as residents. Therefore, liability for worldwide income shall not be applied to them. Non-residents are only liable to pay tax on their income derived from their incomes in Turkey. Within the scope explained above, the income may consist of the elements listed below:

- Business profits
- Agricultural profits
- Salaries and wages
- Income from independent personal services
- Income from immovable property and rights (rental income)
- Income from movable property (income from capital investment)
- Other income and earnings

Individual income tax rate varies from 15% to 35% which is applied as follows for 2017:

Income Scales (TRY) (Employment Income)	Rate (%)	Income Scales (TRY) (Non-Employment Income)	Rate (%)
Up to 13,000	15	Up to 13,000	15
Up to 13,000	20	13,001-30,000	20
Up to 13,000	27	30,001-70,000	27
Up to 13,000	35	70,001 and over	35

## CORPORATE INCOME TAX

The corporate tax is levied on the income and earnings derived by corporations and corporate bodies. The income elements of CIT Law are the same as those covered in the PIT Law. Therefore, many rules and provisions of PIT Law is also applied to CIT Law. The following are specified as tax payers under the CIT regime:

- Capital companies and similar foreign companies
- Cooperatives
- Public enterprises
- Enterprises owned by foundations societies and associations
- Joint ventures

According to the CIT Law, the legal entities covered by the law are the ones with a registered head office in Turkey, or the centre of all business transactions being in Turkey. These entities will be taxed on their world-wide income (unlimited liability). The terms registered office is used as to include head office of the taxable corporations as determined within their laws and rules on their incorporation or their articles of association.

In general, the net corporate income is defined as the difference between the net worth of assets owned at the beginning and at the end of the fiscal year. Expenses such as general expenses made for earning and maintaining business profit, insurance and pension premiums, expenses for vehicles which are part of the enterprise and used in the business, depreciations set aside according to the provisions of the Tax Procedure Law, etc., can be deducted from the revenues.

The corporate income tax rate levied on business profits is 20%.

A 15% withholding tax is applied when dividends are paid to shareholders of resident corporations. However, no withholding tax is applied in case of a payment of a dividend by a resident corporation to another resident corporation. For non-resident corporations, a 15% withholding tax will be applied to remittance of profits to headquarters.

Capital gains derived by a company generally are taxable as ordinary income. However, 75% of capital gains derived from the sale of domestic participations are exempt from corporation tax subject to certain conditions which include sale of property and transfer of shares.

The annual corporate tax return is used for reporting of net corporate profits realized in the course of one accounting period. It shall be submitted to the tax office, which the taxpayer is affiliated to, starting from the first day until the evening of the 25th day of the 4th month following the closing month of fiscal period. The corporate income tax must be paid by the end of the month that the tax return is submitted. Non-resident foreign corporations use special tax return for reporting certain profit and earnings. Special tax return must be given within 15 days from the obtainment of earnings and profit.

## TAXES ON EXPENDITURE

Apart from the income tax on personal and corporate income, there are various taxes on expenditure under the Turkish tax regime which may be classified in general as follows:

### ► Value Added Tax (VAT)

*The general VAT rate is set at 1%, 8%, and 18%. Commercial, industrial, agricultural, and independent professional goods and services, goods and services imported into the country, and deliveries of goods and services as a result of other activities are all subject to VAT. Exemptions on VAT include exports of goods and services, petroleum exploration activities, transit transportation, services rendered at harbors and airports for vessels and aircrafts, etc.*

### ► Special Consumption Tax (SCT)

*There are four main groups of goods which are subject to SCT on different rates:*

- Petroleum products, natural gas, lubricating oil, solvents, and derivatives of solvents
- Automobiles and other vehicles, motorcycles, planes, helicopters, yachts
- Tobacco and tobacco products, alcoholic beverages
- Luxury products

► **Stamp Duty**

*Stamp duty is applied to documents, including contracts, notes payable, capital contributions, letters of credit, letters of guarantee, financial statements, and payrolls. It is levied as a percentage of the value of the document which range from 0.189% to 0.948% and is collected as a fixed price (a pre-determined price) for some documents.*

► **Banking and Insurance Transaction Tax**

*Banking and insurance company transactions are exempted from VAT but are subject to a Banking and Insurance Transaction Tax. This tax applies to income earned by banks, such as loan interest. The general rate is 5%, however some transactions, such as interest on deposit transactions between banks, are taxed at 1%.*

• **Double Taxation Relief**

Foreign shareholders of companies incorporated in Turkey can benefit from double taxation agreements. Turkey signed double taxation agreements with over 80 countries which include EU members and other countries such as USA, Norway, Qatar, Denmark, Malta.

# Turkey | FOREIGN INVESTMENT

Turkey is an attractive location for foreign investors for various reasons such as its young and dynamic population, being a transit country to major markets, like the CIS, the Middle East, and North Africa and being a civil law country which has been aligning its legislation to the EU acquis.

Turkey took the necessary legal steps in the past 15 years to encourage and promote foreign direct investment and enacted various legislations. Within this scope, the Foreign Direct Investment Law (FDI Law) no. 4875 which was enacted in 2003 was a milestone.

As per the FDI Law, foreign investors can freely transfer abroad: net profits, dividends, proceeds from the sale or liquidation of all or any part of an investment, compensation payments, amounts arising from license, management and similar agreements, and reimbursements and interest payments arising from foreign loans through banks or special financial institutions.

As per the FDI Law, the following are accepted as a foreign direct investment:

1. Establishing a new company or branch of a foreign company by foreign investor
2. Share acquisitions of a company established in Turkey (any percentage of shares acquired outside the stock exchange or 10 percent or more of the shares or voting power of a company acquired through the stock exchange) by means of, but not limited to the following economic assets:

#### **Assets acquired from abroad by the foreign investor**

- Capital in cash in the form of convertible currency bought and sold by the Central Bank of the Republic of Turkey
- Stocks and bonds of foreign companies (excluding government bonds)
- Machinery and equipment,
- Industrial and intellectual property rights

#### **Assets acquired from Turkey by foreign investor**

- Reinvested earnings, revenues, financial claims, or any other investment-related rights of financial value
- Commercial rights for the exploration and extraction of natural resources

There are also various bilateral agreements signed with different countries for promotion and protection of investments and double taxation prevention treaties.

As of June 2017, there are over 55000 companies with foreign capital and 800 liaison offices in Turkey which were established by foreign companies as per the statistics of the Ministry of Economy<sup>1</sup>.

<sup>1</sup> [https://www.economy.gov.tr/portal/faces/home/fdi?\\_afriLoop=2984061131624967&\\_afriWindowMode=0&\\_afriWindowId=c40139m6q&\\_adf.ctrl-state=ocpoqr19y\\_208#%40%40%3F\\_afriWindowId%3Dc40139m6q%26\\_afriLoop%3D2984061131624967%26\\_afriWindowMode%3D0%26\\_adf.ctrl-state%3Docpoqr19y\\_212](https://www.economy.gov.tr/portal/faces/home/fdi?_afriLoop=2984061131624967&_afriWindowMode=0&_afriWindowId=c40139m6q&_adf.ctrl-state=ocpoqr19y_208#%40%40%3F_afriWindowId%3Dc40139m6q%26_afriLoop%3D2984061131624967%26_afriWindowMode%3D0%26_adf.ctrl-state%3Docpoqr19y_212)

## • Registration of investment

The FDI Law is based on the principle of equal treatment, allowing international investors to have the same rights and liabilities as local investors.

As per Article 3 of the FDI Law, unless stipulated by international agreements and other special laws, foreign investors are free to make foreign direct investments in Turkey and foreign investors shall be subject to equal treatment with domestic investors. Foreign direct investments shall not be expropriated or nationalised, except for public interest and upon compensation in accordance with due process of law.

Apart from establishing a liaison office, no permit is required from foreign investors for establishing a company. Foreign investors may establish any form of company set out in the Turkish Commercial Code (TCC), which offers a corporate governance approach that meets international standards, fosters private equity and public offering activities, creates transparency in managing operations. In addition, they can establish unincorporated partnerships which include partnerships established through agreements under names such as ordinary partnerships, consortiums, business partnerships, joint ventures that do not conform to the explicit features of the company types designated in the Turkish Commercial Code.

Companies and branches established by foreign investors are required to provide information on their capitals and operations, on the payments made to their equity accounts, on share transfers made between current domestic or foreign shareholders or to any domestic or foreign investor outside the company for statistical purposes.

## • Setting up a business

It is easy to set up a business in Turkey. A standard company incorporation takes 5-7 days to complete the registration process with the relevant Trade registry and the tax authorities before it starts commercial activities.

The conditions for setting up a business and share transfer are the same as those applied to local investors. (please see the chapter regarding Corporate for further information).

## • Bilateral Treaties

Turkey signed various bilateral investment treaties with different countries to protect and promote foreign direct investment, establish a free trade area and there are also various treaties in place to prevent double taxation. <sup>2</sup>

## • Investment Incentives

Under Turkish law, there are several investment incentive schemes in place and the investments benefit from VAT exemption, customs duty exemption, tax reduction, income tax withholding allowance, social security premium support (employer's share), social security premium support (employee's share), interest rate support, land allocation, VAT refund in general. Investments to sectors such as energy, infrastructure, tourism, technology are promoted substantially and incentives differ in accordance with the regions where the investment is made.

## • Foreign employees

Pursuant to the FDI Law, the procedures and principles of foreign personnel which will be employed within companies operating within the scope of the FDI Law are regulated by the Regulation on Employment of Foreign Personnel in Foreign Direct Investments. Within the scope above, this Regulation shall be applied to the employment of foreign key personnel in special foreign direct investments and liaison offices. The special foreign direct investment is a company or a branch within the scope of the FDI Law which fulfil at least one of the conditions below:

- The company's or branch's last annual turnover amounting to at least 100,2 Million Turkish Lira, under the condition that the total capital share of the foreign shareholders amounts to at least 1.133.150 Turkish Lira
- The company's or branch's last annual exports amounting to at least 1 million US Dollars, under the condition that the total capital share of the foreign shareholders amounts to at least 1.133.150 Turkish Lira
- Employment of at least 250 registered personnel with the company or branch within the last year, under the condition that the total capital share of the foreign shareholders amounts to at least 1.133.150 Turkish Lira
- If the company or branch is making an investment, the minimum fixed investment amount foreseen shall being at least 33,3 Million Turkish Lira
- The principal company featuring any direct foreign investment in at least one more country apart from the country where its head offices are situated

<sup>2</sup> <http://investmentpolicyhub.unctad.org/IIA/CountryOtherIias/214#iialnnerMenu>



For liaison offices, work permits are issued to a maximum of one person limited with the period of letter of authority provided that a letter of authorization is obtained from the Ministry of Economy. The personnel of any company being incorporated in Turkey and that is a corporate body, featuring at least one of the following conditions shall be considered as “Key Personnel”

- Working in the company's senior management or executive position
- Managing the entire or a part of the company
- Supervising or checking the works of the company's auditors, administrative or technical personnel
- Taking new personnel to the company or terminating the employment of those existing or making suggestions in this subjects
- Any person featuring the knowledge considered essential for the company's services, research devices, technics or methods
- Maximum one person in the liaison offices, who has been issued a letter of authorization by the principal company abroad.

Therefore work permits are issued by the Ministry of Labour and Social Security for key personnel that will be employed in foreign direct investments.

On the other hand, the Law on the International Labour Force (“**LILF**”) no. 6735 shall be applied to foreign personnel employment apart from the key personnel of the special foreign direct investments and foreign direct investments which do not meet the criteria defined above.

In 2016, the LILF was enacted to determine Turkey's international labour policy and its application. The Law determines the procedures and principles that will be applied to work permits of foreigners and work permit exemptions.

Within the scope of the LILF, work permits may be issued as definite, indefinite, and independent permits. For the first applications, the work permit may be issued for a maximum period of one year. For foreigners holding long-term residency permit or at least eight years legal work permit, application can be made for an indefinite work permit.

Pursuant to the LILF, a manager of a limited company and a board member of a joint stock company which are also a shareholder may work via obtaining a work permit. On the other hand, board members of joint stock companies who do not reside in Turkey or shareholders of other types of companies who do not have management authority may qualify for work permit exemptions. Therefore these persons may work via obtaining a work permit exemption.

# Turkey | LABOUR LAW

There are three main legislation governing labour law in Turkey, which are Turkish Labour Law (Labour Law) no. 4857, the Law on Trade Unions and Collective Bargaining Agreements (Union Law) no. 6356 and the Law on Civil Service Trade Unions and Collective Bargaining Agreements no. 4688. Under the Labour Law the following are the main categories of employment:

- Continual/transitory contracts: transitory contracts are made up to thirty days due to nature of the work, whereas continual work requires a longer period.
- Full time/part-time contracts: the contract will be part-time if the working hours are determined shorter than the regular working hours under the Labour Law which is 45 hours.
- Definite (fixed) term/indefinite contracts: if a contract of employment is not made for a fixed term it will be accepted as an indefinite contract under the Labour Law. In addition to a fixed term, the contract may be definite term if it is made for completing a specific task or occurrence of a certain event.
- Temporary employment contracts: Temporary employment may be established via employment agencies or assignment of an employee in a different work place within the same holding company or group of companies.

Under Turkish labour law regime real persons employed via a contract of employment are employees. The contract will be accepted as a contract of employment if it requires one party to perform work in subordination as an employee and one party to pay salary in return. A written agreement is mandatory if the term of the contract is one year or more.

The person will be self-employed under the labour law and social security regime if services are provided without a contract of employment which is usually under a consultancy agreement or an agreement which does not include the conditions of a contract of employment.

## • Principals of labour law

The Turkish Constitution applies the principle of a social legal state and social and economic rights with regards to employment such as freedom to work, right to rest, right to establish, right of collective bargaining agreements, right to strike are regulated and protected.

The Labour Law regulates the working conditions and work-related rights and obligations of employers and employees working under an employment contract. The equal treatment principal applies to the relationship of employment which prohibits discrimination based on language, race, sex, political opinion, philosophical belief, religion and sect or similar reasons.

If the employer violates the equal treatment principle in the execution or termination of the employment relationship, the employee may demand a compensation up to his/her four months' salary.

## • Wages and minimum working hours

Under the Labor Law, the maximum regular working hours are 45 hours per week which should be divided equally among the working days in principle. Total overtime work shall not be more than two hundred seventy hours in a year.

Hours exceeding the limit of 45 hours per week will be constituted as overtime and salary for each hour of overtime will be one and a half times the normal hourly rate. Minimum wage is determined by the Ministry of Social Security and Labour and the current amount is TRY 1.777,50 (gross).

## • Holiday

The annual leave is determined as follows within the Labour Law:

- For service of employment between one to five years:  
**at least 14 days**
- For service of employment between five to ten years:  
**at least 20 days**
- For service of employment for more than fifteen years:  
**at least 26 days**

The issue of whether or not work will be done on the national day and public holidays will be decided by a collective labour agreement or by contracts of employment. The employee's consent is required for work during holidays if there is no provision in the collective agreement or in employment contracts.

## • Collective labour agreements

According to the official statistics released by the Ministry of Social Security and Labour, the unionization rate is 12% for Turkey currently.

The Union Law regulates the collective labour agreements and they can be concluded between trade unions and employer unions. The collective labour agreements contain provisions related to conclusion, content and expiration of a contract of employment. It shall be concluded for a period of not less than one year and not more than three years. A contract of employment cannot be contrary to a collective labour agreement.

Workers who are not a member of the trade union that is a party to the collective labour agreement at the date of signature, or those who are subsequently recruited but do not join the union, or those who are expelled or resigned from the union after the said date may avail themselves of the agreement by paying the solidarity subscription to the trade union.

## • Executive officers

There is no specific provision with regards to executive officers within the Labour Law. Nevertheless, the employer's representative is defined as the person acting on behalf of the employer and charged with the direction of work, the establishment and enterprise. The employer is directly liable towards the employees for the conduct and responsibilities of his representative acting in this capacity. Therefore an executive officer of a company may be classified as an employer's representative provided that the aforementioned conditions are satisfied.

Any obligations and responsibilities for which the employer is liable under the Labour Law shall also be borne by the employer's representative. An employer's representative will still benefit from the rights and obligations provided to employees under the Labour Law. However, certain provisions of the Labour Law regarding job security under certain conditions will not be applicable to employer's representatives.

## • Termination, Job Security and Severance Pay

A contract of employment can be terminated by the parties by serving a notice to the party or with immediate effect by relying on a just cause as defined within the Labour Law. For a contract of employment signed for an indefinite period the notice periods that should be complied with are as follows:

- Up to 6 months employment:  
**Two weeks' notice**
- 6 to 18 months employment:  
**Four weeks' notice**
- 18 months to 3 years employment:  
**Four weeks' notice**
- Employment longer than 3 years:  
**Eight weeks' notice.**

Alternatively the employer or the employee may choose to opt out from notice periods by payment in lieu of notice period.

The Labour Law provides protection for employees under certain conditions. Accordingly, if an employee with an indefinite contract of employment has been working for at least six months at a workplace which has 30 or more employees, the employer can only terminate the employment contract by relying on a valid reason. Otherwise the employee may file a reinstatement lawsuit and will be entitled to a compensation of 4 to 8 months' salary if the employer loses the lawsuit and does not initiate reinstatement.

The severance pay is also regulated by the Labour Law. Within this scope, an employee who terminates his/her contract of employment as per the conditions indicated in the Labour Law or whose contract of employment contract is terminated by the employer must be compensated with a severance pay. The severance pay will be calculated based on the employees' seniority at the work place and in general to qualify for a severance pay, the employee should be working at the workplace for at least one year.

## • Maternity, paternity and parental leave

In principle female employees must not be engaged in work for a total period of sixteen weeks, eight weeks before confinement and eight weeks after confinement. In case of multiple pregnancy, an extra two week period shall be added to the eight weeks before confinement during which female employees must not work. These time periods may be increased before and after confinement if deemed necessary in view of the female employee's health and the nature of her work.

If the female employee so wishes, she shall be granted an unpaid leave of up to six months after the expiry of the sixteen weeks, or in the case multiple pregnancy, after the expiry of the eighteen weeks indicated above. Female employees shall be allowed a total of one and a half hour nursing leave in order to enable them to feed their children below the age of one. The employee shall decide herself at what times and in how many instalments she will use this leave. The Labour Law does not regulate paternity and parental leave.

Absence from work during maternity leave does not constitute a valid reason for termination and in such case the employee may file a lawsuit and claim compensation and/or reinstatement.

## • Collective redundancy

Under the Labour Law, when the employer contemplates collective redundancy for reasons of an economic, technological, structural or similar nature necessitated by the requirements of the enterprise, the establishment or activity, a written notification must be made to the union representative at the workplace, the relevant Regional Directorate of Labour and the Public Employment at least 30 days prior to the intended lay-off. A collective dismissal occurs when:

- In establishments employing between 20 and 100 employees, a minimum of 10 employees
- In establishments employing between 101 and 300 employees, a minimum of 10 percent of employees
- In establishments employing 301 and more workers, a minimum of 30 employees, are to be terminated on the same date or at different dates within one month.

Consultations with union representative shall take place after the said notification for discussing measures to be taken to avert or to reduce the terminations as well as measures to mitigate or minimize their adverse effects on the workers concerned. A document showing that the said consultations should be drawn up at the end of the meeting. Notices of termination shall take effect 30 days after the notification of the regional directorate of labour concerning the intended lay-offs.

If an employer does not comply with the notification and consultation requirements, an administrative fine will be payable for each employee subject to the collective redundancy.

- **Requirement to employ disabled persons, ex-convicts and terror victims**

In establishments employing fifty or more employees, employers are required to employ disabled persons, ex-convicts, and victims of terror as per the related legislation and assign them to jobs consistent with their occupational skills and physical and mental capacities. The ratios are determined by the Council of Ministers each year.

- **Transfers of undertakings**

Under the Labour Law, when, due to a legal transaction, the establishment or one of its sections is transferred to another person, contracts of employment existing in the establishment or in the section transferred on the date of the transfer shall pass on to the transferee with all the rights and obligations involved.

The transferor and transferee will be jointly liable for the obligations which have materialised before the transfer and which must be defrayed on the date of the transfer. The liability of the transferor will continue up to two years following the date of the transfer.

The transferor or transferee is not authorised to terminate the contract of employment solely because of the transfer of the establishment or a section and the transfer does not entitle the employee to terminate the contract for just cause. The right of the transferor or the transferee to terminate for reasons necessitated by economic, technological or organisational changes and the employer's and the employee's right to break the contract for just cause are reserved.

- **Labour Courts**

Labour Courts are the specialist courts for hearing disputes between the employer and the employee such as claims on reinstatement, overtime, severance compensation, notice payment and moral damages.

Currently there is a Draft Law amending the Labour Law which will set mandatory mediation as a dispute resolution method before going to the Labour Courts for claims on salary and reinstatement.

# Turkey | REAL ESTATE

The real estate & construction sectors made a significant contribution to the economic growth in Turkey within the past 10-15 years. The amendments to the relevant laws and regulations for facilitating acquisition of real estate by foreigners and foreign companies, urban renewal and mass housing projects that are either guaranteed or undertaken by the state together with high yield ratios have all increased the participation of foreign investors to Turkish real estate market.

In general, the Turkish Civil Code no. 4721, the Condominium Law no. 634 and the Land Registry Law no. 2644 regulates the acquisition and transfer of real estate, registration procedures and requirements and rights and obligations of the owners of real estate.

Pursuant to the Turkish Civil Code, the owner of a property is entitled to use, benefit and dispose of such property in any way he/she wishes within the boundaries of the order of laws. General information with regards to real estate will be provided below specifically in terms of foreigners and companies with foreign capital:

## • Types of real estate

The Article 704 of the Turkish Civil Code lists the following as subjects of real estate ownership:

- Land
- Independent and permanent rights registered in a separate page in the Land Registry Records
- Independent units registered in the Condominium Registry Records

The title deed will show the purpose of use of land, building or independent units as in commercial, residential, agricultural. With regard to building units change of use from commercial to residential or vice versa is possible by making the necessary applications to the related municipalities and obtaining confirmation from the board of condominium owners as per the related legislation.



- **Acquisition of real estate**

In case of ownership of land, ownership shall cover the space and layers both above and under the ground of the subject land, to the extent of benefits of such use. Therefore, existing buildings on the land will also be included in the subject of ownership on the real estate.

Ownership of real estate is acquired upon registration in the Land Registry. In case of a contract for transfer of ownership, a sales commitment agreement should be signed before the Turkish notaries. However, the legal ownership of the property shall only pass via official deed and registry signed at the Land Registry Directorates.

- **The Condominium Law**

The Condominium Law regulates the condominium ownership rights that can be established on separate or particular parts of the property (such as a flat, or apartment, office bureau, shop or store) which are available for use or will later be put in use by the real estate owner or his associated owners.

This law is significant since ownership on real estate are generally converted to condominium ownership which requires conversion of the whole main estate. Conversion to condominium ownership is also executed at the Land Registry Directorates via registration by the owner(s) or stakeholder(s) of the whole main estate.

- **Foreign ownership**

With the amendment to the Article 35 of the Land Registry Law no. 2644 in 2012, the condition of reciprocity for foreigners who intend to buy a property in Turkey was abolished. Pursuant to Article 35 of the Land Registry Law, real and legal persons with foreign nationality can buy any kind of property (house, business place, land, field) subject to the related legal conditions as explained below:

## ACQUISITION BY FOREIGN REAL PERSONS<sup>1</sup>

- Persons with foreign nationality can buy maximum 30 hectares of property in Turkey in total and can acquire limited in rem right
- Foreigners cannot acquire or rent property within military forbidden zones and security zones
- Persons with foreign nationality can acquire property or limited in rem right in a district/town up to 10 % of the total area of the said district/town
- Legal restrictions do not apply in setting mortgage for real persons and commercial companies having legal personality which are established in foreign countries
- **The properties are subject to winding up provisions in following cases:**
- If the properties are acquired in violation of laws
- If the relevant Ministries and administrations identify that the properties are used in violation of purpose of purchase
- If the foreigner does not apply to the relevant Ministry within time in case the property is acquired with a project commitment
- The projects are not materialized within time

## ACQUISITION BY FOREIGN COMPANIES

- **Foreign companies which are established according to the relevant laws of their countries of origin can acquire property and limited in rem rights within the provisions of special laws. These special laws are:**
- No restriction is implemented in favor of the said commercial companies in establishing mortgage.
- Other foreign corporations (i.e. foundation, association,...) are not allowed to buy property and acquire limited in rem right.
- Petroleum Law No. 6326
- Law on Encouragement of Tourism No. 2634
- Law on Industrial Zones No. 4737

## ACQUISITION BY COMPANIES WITH FOREIGN CAPITAL

The companies with foreign capital can buy property in Turkey in accordance with Article 36 of Land Registry Law and the “Decree on Acquisition of Property and Limited in Rem Rights by Companies and Corporations”.

Accordingly, the companies with foreign capital which are incorporated in Turkey which means the foreign real persons or foreign corporations which are established according to the relevant laws of their countries of origin

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<sup>1</sup> The foreign real person must be citizens of a country which the Council of Ministers has determined to be entitled to acquire real estate in Turkey. Information can be obtained from the Land Registry Directorates for entitled countries.

- Hold individually or collectively 50% or more shares
- Foreign real persons or corporations have a right to assign or remove the managers of the said companies

could buy property and acquire limited in rem rights in Turkey for performing the activities defined under their articles of incorporation. The same conditions will also apply to direct or indirect shareholding of a company incorporated in Turkey by the companies defined above under the following circumstances:

- The shareholding ratio of the companies defined above reaches 50% or more directly or indirectly
- 50% or more shares of the Turkish company owning the property is acquired directly or indirectly
- The shareholding ratio of foreign investors reach to 50% or more via transfer of shares within Turkish companies with foreign capital which owns the property.

In general permits from the related military authorities or governorships are required for acquisition of a property within military forbidden zones, military security zones and other zones determined pursuant to the respective legislation.

## • Title Deed and Procedure for Acquisition

As stated above the legal ownership of the property shall only pass via official deed and registry signed at the Land Registry Directorates. Information including the name, surname, father's name of the seller and the buyer, purpose of acquisition and date (full title in case of a legal person), in case of joint ownership each owner's share proportion and servitudes and liens attached to the property may be reviewed from the title deed.

For acquisition of property, initially an application should be made with the relevant documentation should be made to the Land Registry Directorate. Upon reviewing the documentation and approval of the transfer, actual title transfer will occur. Both seller and the buyer is required to be present at the Directorate for transfer unless a proxy is authorized to act on behalf of one of the parties. A sale agreement will be entered at the Directorate and therefore the parties should agree on the terms of the sale prior to the actual transfer.

Under Turkish law it is not compulsory to hire a real estate agent or an attorney. However, it is advisable to seek legal advice in order to gather further information about zoning plans, physical condition of the property, any unpaid taxes, encumbrances on the property and to prepare the necessary paperwork for application and actual transfer.

## • Taxes and duties

Under Turkish law, the buyer must pay the sale price and the seller must allow the buyer to have occupation of the property following the title transfer at the Land Registry Directorate.

To prevent tax avoidance, the sale price cannot be less than the market price determined by the relevant governorship. The sale price is set out within the Title Deed and the Title Deed Fee which should be paid by both the buyer and the seller will be calculated as per this amount. In addition to the Title Deed Fee, the circulating capital fee which is determined locally is required to be paid by the seller.

If there is a sales commitment agreement between the seller and the buyer notary fee and stamp duty will also be required to be paid prior to the actual transfer. VAT will be applicable to the sale of real estate if a commercial income is derived from the sale by the seller. The VAT will depend on the net area of the real estate. As a rule, the VAT is required to be paid by the seller, however in practice the seller generally adds the VAT amount on the sale price which results in the buyer paying this VAT amount.

In 2017 Turkey granted a VAT exemption to foreigners for the initial purchase of a property by a foreigner as a residence or office, provided that the property is held for at least one year and the purchase was made with foreign currency.<sup>2</sup>

For benefitting from the exemption, at least 50% of the amount must be paid before the date the acquisition invoice is issued, with the balance paid within one year and following parties are eligible for exemption:

- Foreign real persons who are not residing in Turkey.
- Turkish citizens living abroad for more than six months (with exceptions).
- Legal entities which have registered offices and headquarters outside Turkey, which do not generate any income in Turkey through a workplace or resident representative.

## • Zoning Law

The Zoning Law no. 3194 defines and determines the zoning plans and standards for land development process of lands within or without the boundaries of municipalities and urban areas.

<sup>2</sup> The Communiqué Amending the Communiqué on General Value Added Tax Application

The following plans are defined within the Zoning Law:

- Regional Plans are prepared for determining the socio-economic development trends, development potential of settlements, sectoral aims, distribution of activities and infrastructures.
- Environmental Plans determine the use of land as per the regional plans such as residential, industrial, agricultural, tourism and transportation.
- Implementation Development Plans are plans drawn as per the principles of the master plans and they determine the construction blocks of various regions, their density and order, implementation phases which are necessary for roads and application in detail.
- Master Plans are zoning plans in which the general use functions, main region types, future population densities of regions, structural density, development direction, sizes and principles of various settlement areas, transportation systems and problem resolution methods of the plots of land are shown. These plans are drawn on the regional or environmental plans through inscription of cadastral status and they are detailed within a report which constitute a whole together.

The Master Plans and Implementation Development Plans are prepared by the relevant municipalities as per the principles of regional plans and environmental plans. They enter into force upon approval by the municipal council. For areas outside the municipal boundaries the plans will be prepared and approved by the relevant governorship.

The main principle of the zoning law is the hierarchy of plans which require a lower scale plan to comply with an upper scale plan. Therefore, master plans and implementation development plans cannot contradict to regional plans and implementation development plans cannot contradict to master plans.

In terms of real estate (properties), for construction to start at a certain zone, the zoning structure described above should exist within that area. Except certain exemptions under the Zoning Law, a construction permit should be obtained for starting the works and upon completion of the construction occupancy permit will be issued by the relevant municipality or governorship if all the relevant legal rules and standards are complied with. For agricultural land, no planning can be made for a use of land apart from agriculture unless the relevant permits are obtained as per the Soil Conservation and Use of Land Law.

## • Commercial leases

The Turkish Code of Obligations (TCO) no. 6098 regulates the commercial leases. TCO's aim is to protect the tenant's rights towards the landlord which is considered as the weaker party both by the scholars and courts. This approach was also adopted by the previous code of obligations.

It must be emphasized that under the TCO there is a specific distinction among types of commercial leases. Accordingly commercial leases are separated as commercial leases and roofed workplace leases. Some provisions only apply to roofed workplace leases. Therefore for example if a land is leased without any building on it, the general provisions of the TCO will apply to the relevant lease contract. Whereas if a unit of a building or a building is leased the aforementioned specific provisions will be applicable. It must be noted that some of the provisions regarding roofed workplace leases have been postponed to 1 July 2020.

### **DURATION**

The period of lease can be freely determined by the parties as per TCO which requires a fixed term or an indefinite term. Accordingly, the lease contract will be for a fixed term if the period of the contract will come to an end without notification.

For commercial leases, the duration will be deemed as extended for a year with the same conditions unless a notification is made at least fifteen days before the end of the duration of the contract.

### **RENT**

The rent may be freely agreed by the parties within the lease contract. Nevertheless there are specific provisions regulating determination of the rent under the TCO which is not enforceable until 1 July 2020 as described below under the Article 344.

Accordingly for roofed workplace leases, the renewed rent as agreed by the parties may not exceed rate of the increase under the producer price index of the previous year of lease. This article will also be applicable to roofed workplace leases which are longer than a year. The index is determined by the Turkish Statistical Institute each year.

For roofed workplace leases which are longer than five years or renewed after a period of five years and for the end of each five-year period, the renewed rent will be determined by a judge in accordance with the increase rate of the index, the status of the leased property and equity. This provision will be applied regardless of whether the parties have reached an agreement about this matter or not.

With reference to rent in foreign currency, the parties may not make an amendment to the amount of rent unless five years have passed. The only exception to this rule is the Article 138 of the TCO which regulates hardship where one of the parties to a contract requests from a judge to adapt the contract as per extraordinary situations. It should be noted that under TCO the conditions for adaptation are very difficult.

### **PROHIBITION PREVENTING AMENDMENTS TO THE DETRIMENT OF THE LESSEE**

As stated above the TCO has a protective approach in favour of the lessee in terms of lessee and lessor balance. Therefore as per Article 343 which applies to residence and roofed workplace leases, the parties may not make an amendment to the detriment of the lessee apart from determining the rent, afterwards the conclusion of the contract

### **ALTERATION**

As per the general provisions, renewal and alterations which should not necessitate termination of the contract and that can be expected to be endured by the lessee may be made to the property by the lessor. The lessor's written confirmation is required for renewal and alterations that will be made by the lessee.

### **USE AND CONSTRUCTION**

The lessor is required to hand over the property at the agreed contractual date in a condition which is suitable for the use of the property as intended by the contract. This also includes the property to be legally suitable and hold any relevant permits such as occupancy permit.

## **SUBLEASE AND ASSIGNMENT**

Provided that no alteration is caused which may damage the lessor, the lessee can freely sublease whole or part of the property or transfer the right of use. However, sublease and transfer of right of use is not allowed for residence and roofed workplace leases, unless a written confirmation is obtained from the lessor. A written confirmation is required in order to assign the lease as per TCO, however for commercial leases (apart from roofed workplace) the lessor cannot avoid providing permission without a valid reason. For commercial leases the lessee will be jointly and severally liable with the assignee for up to two years. Sublease and assignment are generally prohibited within the commercial leases and/or roofed workplace leases with the valid reasons defined under the contract.

## **TAX, INSURANCE AND EXPENSES**

Unless the parties determine otherwise or it is prescribed by the law, mandatory insurance, tax and similar burdens regarding the leased property shall belong to the lessor. This liability shall also extend to collateral expenses regarding the use of the property. Nevertheless, for residence and roofed workplace leases, unless it is agreed otherwise the expenses related to heating, lighting, water, electricity, etc., shall belong to the lessee. These types of expenses are generally agreed to be paid by the lessee under the commercial leases.

## **TERMINATION**

As per the general provisions on leases, fixed term leases will terminate at the end of its duration. For indefinite term leases, unless it is agreed otherwise, each party may terminate the contract as per the period of termination and notification periods defined by the TCO which will be applicable to commercial leases in general. With reference to residence and roofed workplace fixed term leases there is a specific provision which requires a written notification to be made by the lessee at least fifteen days prior to the end of the duration of the lease contract. Otherwise the contract will be deemed to have extended for one year with the same contractual terms. Therefore the lessor cannot terminate the contract solely due to end of the duration of the contract. However, if the contract has extended for a period of ten years, the lessor may terminate the contract without any reason provided that a written notification is made at least three months before the expiry of the extension period. For indefinite term residence and roofed workplace leases, the lessor may terminate the contract as per the general provisions afterwards a ten-year lease period. On the other hand the lessee may terminate the contract any time as per the general provisions. In terms of residence and roofed workplace leases the TCO also allows the lessor to terminate the contract via filing a lawsuit for certain reasons such as reconstruction of the leased property, material refitting of the property due to zoning which are prescribed by the TCO.



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Ukraine

Arzinger

United Kingdom

McCarthy Denning Limited

# Arzinger

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## Ukraine

### 📍 Head Office

Senator Business Centre  
32/2 Moskovska St., 10th Floor;  
01010, Kyiv, Ukraine;

☎ +38 044 390 55 33

☎ +38 044 390 55 40

### 📍 West Ukrainian Branch

6, Generala Chuprynyk St.,  
Office 1, 79013, Lviv, Ukraine;

☎ +38 032 242 96 96

☎ +38 032 242 96 95

### 📍 South Ukrainian Branch

Pokrovsky Business Centre  
33, Zhukovskogo st., 6th Floor,  
office 601, 65045, Odesa,  
Ukraine;

☎ +38 048 711 74 74

☎ +38 048 249 62 45

[www.arzinger.ua](http://www.arzinger.ua)

### General information

Arzinger is an independent law firm headquartered in Kyiv and having its regional offices in Western and Southern Ukraine. For over 15 years, Arzinger has been among the legal business leaders providing high-quality legal support to clients throughout Ukraine. Among the firm's many clients are top representatives of the international and local business.

Arzinger follows high standards of legal services and is an reliable partner in view of its great experience in a wide range of industries and legal practices: M&A, corporate law, real estate and construction, antitrust and competition, litigation and arbitration, IPR, tax, banking & finance, PPP, public procurement, labour law, regulatory, private equity / investments, capital markets and IPOs. We serve clients operating in financial services, energy, mining and natural resources, pharmaceuticals, food & beverages, investment banking and corporate finance, telecommunications, retail & leisure, hospitality, aviation and automotive, agriculture, insurance, and infrastructure & transport industries.

Arzinger employs the highly qualified professionals with vast hands-on experience in a wide range of legal matters, deep knowledge and understanding of the local market, international education and background. The firm has a team of over 60 seasoned legal professionals led by 8 partners. All of them are acknowledged among leading experts on the Ukrainian legal market and are recognised by reputable international and local rankings.

As a result, Arzinger can offer extensive legal assistance to effectively support a variety of complex and challenging transactions, including cross-border matters. Arzinger closely cooperates with legal advisors from numerous jurisdictions and is a member of international professional organizations, which enables us to engage our colleagues from various jurisdictions in cross-border transactions and provide our clients with the top-level professional legal advice.

# Ukraine | CORPORATE LAW & FOREIGN INVESTMENT

One of the major features of Ukrainian corporate law is that it is now encountering significant reformation aiming at further liberalization of activities of private companies and, in parallel, improving corporate governance, transparency and accountability of public companies. It is expected that the mentioned multi-faceted reformation process will foster business climate in Ukraine, as well as attract foreign investors (first and foremost, international financial institutions and multinational corporations) by setting understandable and comprehensive rules of game at the domestic market.

For the reasons stated, through 2016–2017 and onward the whole set of obsolete legislative corpus, which, in fact, ceased to reasonably adhere to actual commercial realities and needs, is being substituted by new regulations. Notably, four draft laws of utmost importance, which are the laws on (i) protection of rights of investors, (ii) increasing of level of corporate governance in state and municipal entities, (iii) corporate agreements, and (iv) squeeze-out / sell-out procedures, have already been enacted by the parliament. Apart from the above, a number of draft laws (notably, the law on limited liability companies and additional liability companies and the law on ease of business and attracting investments by issuers of securities) are also put on the parliamentary agenda.

Corporate law of Ukraine comprises a number of statutory regulations, including codified legal acts. These prescriptions are the major source of regulation of every facets pertaining to incorporation, conducting business activities, corporate governance and cessation of / exit from different types of business entities. General statutory rules are also unfolded in more details in the companies' internal documents (typically, the charter and internal regulations).

The hierarchy of corporate regulations may be described as follows:

- Laws
- Charters or articles of association
- Resolutions of shareholders
- Decisions of executive bodies

Moreover, together with enactment of the Law on corporate (shareholders') agreements in April 2017, it is also expected that such agreements would become an important source of rules for business entities and shareholders.

The said classification is closely connected to the second one which enables us to reveal the idea of such subdivision. In particular, depending on the method of legal regulation corporate law provisions can be divided as follows:

- Imperative (regulations of a strict, imperious nature disallowing any deviations from the rule);
- Dispositive (regulations of autonomous nature enabling the parties to independently agree on how to exercise their corporate rights and fulfill duties).

Imperative provisions establish explicit rules, whereas dispositive rules enable the parties to settle certain issues individually on their own will. Current corporate legislation of Ukraine, as compared with the same in many other countries, is to a greater degree of imperative nature.

For instance, shareholders of a limited liability company (including foreign investors) are often interested in extending the list of issues which can be resolved by a qualified majority of votes. Effective legislation does not provide such opportunity and the parties cannot by themselves deviate from the requirements on the number of votes to adopt valid corporate decisions. The same is with the issue on how the shareholders can cast their votes (voting arrangements).

In many countries lawmakers stipulate more flexible regulations for the issues related to corporate governance (first of all, this refers to private companies the shares of which are not listed at stock exchanges – limited liability companies, private joint stock companies, etc.). Advancing with corporate reforms in Ukraine it is nonetheless expected that a number of imperative regulations will be replaced by dispositive ones and many of the issues will be resolved by shareholders independently (according to their needs and aims pursued). Currently, this perspective is fully reflected in the draft Law of Ukraine “On the Limited Liability Companies and Additional Liability Companies”, which is now considering by the parliament. Along with the above, enhancing corporate governance in joint stock companies, strengthening protection of rights of investors has become subject of intense debates and subsequent legislative improvements. In particular, according to the Law of Ukraine “On protection of rights of investors” which came into legal force as of 1 May 2016, a number of novelties not yet known and applied in Ukraine before have been introduced, such as:

- Derivative action granting the shareholders (meeting 10% cumulative shares threshold) with the right to bring claims against companies' officials seeking to reimburse damages caused by actions or inactions of such officials;
- Concept of independent members of supervisory board (independent directors) that shall meet a number of requirements, such as non-affiliation with the company for the last 5 years; absence of significant relations with the company for the last 1 year; non-receipt of substantial benefits, etc.;
- New rules have been introduced on procedure of approval of significant and interest-related transactions, including the criteria for qualification of transactions as significant and interest-related per se.

It has also become long-awaited event when in June 2016 the parliament passed the Law “On Introducing Amendments to Certain Legislative Acts regarding Management of State-Owned and Municipal Property”. By the said law a set of well-recognized international corporate governance standards have been implemented for state-owned and municipal enterprises. According to the law, the following key corporate governance mechanisms have been introduced, notably:

- Two-tier management structure, whereby supervisory board (appointed upon resolution of authorized management state / municipal body) becomes responsible for appointing executives of the company and supervising their activities. Further to that, majority of supervisory board shall consist of independent directors;
- Enhancing operational transparency in state-owned and municipal companies via publishing a variety of data (e.g. quarter and annual financial statements, audit reports, profiles of CEOs and members of supervisory board, information on their remuneration and principles of its calculation, information on significant and interested party transactions) at the official web-sites of either the companies or authorized management state / municipal bodies.

On 23 March 2017 the draft Law on corporate (shareholders’) agreements was adopted by the parliament. The Law is aimed at significantly advancing corporate governance in joint stock companies and limited liability companies by introducing corporate (shareholders’) agreement as a tool allowing the shareholders to agree among themselves how to exercise their rights and fulfil the duties. The said Law can significantly contribute to the business environment by introducing a number of conventional constructions that are widely applied in European jurisdictions, to mention:

- Voting arrangements (to vote in prescribed matter or refrain from voting on specific matters)
- Negative covenants (obligations to refrain from certain pre-determined actions)
- Rules on share transfers: lock-up, drag along, tag along, options;
- Non-revocable power of attorney.
- Deadlock resolution;

According to the Law, corporate agreements can be binding only upon its parties. The content of the agreement is confidential, unless the parties agree otherwise or the law provides otherwise (e.g. information on the existence, terms and parties of shareholders' agreement of public joint stock company shall be published).

Finally, the latest amendments to the Law on amending of certain legislative acts of Ukraine regarding increase of corporate governance level in joint stock companies (entered into legal force in June 2017) introduced long-awaited squeeze out / sell out procedures, whereby:

- The shareholder who directly or indirectly owns or acquired more than 95% of ordinary shares has the right to buy shares of the remaining minority shareholders (squeeze-out);
- In turn, minority shareholders may equally require the majority shareholder to mandatorily buy their shares in the given case (sell-out).

To sum up, all recent legislative changes in corporate legislation, as well as considering draft laws on the way, prove that the government is aiming to enhance investment inflow to Ukraine.

## • Business companies types

A legal entity in Ukraine can be established in different forms, such as:

- Joint stock company
- Limited liability company
- Additional liability company
- Full company (full liability company)
- Limited partnership

In Ukraine it is also possible to set up a representative office (engaged in either commercial or non-commercial activities) representing the interests of a foreign company in Ukraine. The representative office is not legal entity and exercises its activity only for the benefit of the foreign parent company.

Establishing a legal entity in Ukraine involves registering in the Unified State Register of legal entities, individual entrepreneurs and non-governmental organizations, tax authorities, statistics authorities, pension fund and other social security funds, as well as opening a bank account.

Conducting some types of business activities is subject to licensing requirements in Ukraine, for example: banking activities, provision of financial services, medical practice, production, wholesale or retail sale of medicines, certain activities in energy sector, etc. Full list of licensed business activities is defined by the Law “On Licensing of types of business activities”.

Worth mentioning that at the moment effective legislation envisages two types of limitations on the ownership structure of legal entities, namely – vertical ownership structure limitation and horizontal ownership structure limitation. According to vertical ownership structure limitation only a company with no less than two shareholders (legal or natural person) can act as the sole shareholder of Ukrainian subsidiary company. According to horizontal ownership structure limitation one person (legal and/or natural) can be the shareholder of only one single member Ukrainian subsidiary company. The said limitations are applicable to all type of legal entities.

► **Joint stock company (JSC)**

*A type of legal entity with the authorized capital divided into specified number of shares of equal par value. Participation in JSC entails limited liability of shareholders, where they can be held liable for the company's obligations only in the amount of their shares. Shares are considered as a type of security and therefore their issuance (either initial or subsequent) is subject to registration with the National Securities and Stock Market Commission of Ukraine.*

► **Limited liability company (LLC)**

*A type of legal entity with the authorized capital divided into specified number of shares of equal par value. Participation in JSC entails limited liability of shareholders, where they can be held liable for the company's obligations only in the amount of their shares. Shares are considered as a type of security and therefore their issuance (either initial or subsequent) is subject to registration with the National Securities and Stock Market Commission of Ukraine.*

► **Additional liability company**

*A type of legal entity with authorized capital divided into shares the value of which is determined upon decision of the participants and is reflected in the company's charter. Participants are jointly and severally liable for debts of the company by their individual property in the amount determined in the company's charter pro rata to their shares.*

► **Full liability company**

*A type of legal entity with authorized capital divided into shares the value of which is determined upon decision of the participants and is reflected in the company's charter. Participants are jointly and severally liable for debts of the company by their individual property in the amount determined in the company's charter pro rata to their shares.*

► **Limited partnership**

*A form of partnership in which there is one or more limited partners (owners) in addition to general partners bearing full liability.*



The difference between the above listed business entities mostly relates to: managing procedure, relations and liability of shareholders, requirements to the company's authorized capital and its formation procedure etc.

The best and the most flexible form of legal entity in Ukraine is LLC, insofar as it is much easier and expedient to incorporate (up to 1 week, including opening a bank account), has no minimum requirements as to the amount of charter capital and is less regulated in terms of corporate governance.

Along with LLC, JSC is one of the most common vehicles to conduct business in Ukraine, although both expenditures on the maintenance and complying with regulatory requirements are by several times higher compared to LLC. Just to mention, the minimum amount of share capital of JSC is 1 250 minimum wages, which for now amounts up to 128 000 EUR. Moreover, the National Securities and Stock Market Commission of Ukraine is attentive and scrupulous as to compliance of JSC with statutory requirements. At last but not least, in order to conduct any operations with securities (including issuance of shares of JSC) the shareholders should have a security account open in Ukrainian depository institution. Trade operations with securities, including the shares in JSC, can be conducted within Ukrainian depository system only.

For the reason stated, JSCs are used predominantly in such cases when it is necessary to attract financing from the banks and large financial institutions or for arranging entering of potential partners / co-investors at higher company valuation, or due to requirements of laws as to the legal form for conducting specific activities (such as banks, insurance companies, investment funds).

Contributions to the share capital of legal entities can be made in a variety of forms. For example, by providing monies, in-kind contributions, securities, proprietary rights, intangible assets that are subject to monetary valuation. However, there are restrictions on making contributions by using promissory notes, securities issued by the companies itself, or by incurring by the shareholder of obligation to perform certain works or services for the company. Worth mentioning that at the moment the effective legislation is quite ambiguous on whether the share capital can be formed by means of debt-to-equity conversion mechanism.

## • General Regulation on Limited Liability Companies

LLC is a type of legal entity with authorized capital divided into shares (so-called “participatory interest”) the value of which is determined upon decision of participants and is reflected in the company’s charter. However, participatory interests per se are not considered as the securities and no registration formalities are applied. In fact, participatory interests in LLCs are simply a mathematical proportion of the amount of contribution of the shareholder to the overall amount of authorized capital. Disposal of participatory interest can be conducted on the basis of written agreement (not subject to notary certification), involvement of intermediary (such as broker) is not required either. At the same time, so far as the participants usually have pre-emptive right, prior to any disposal of participatory interest to any third party the selling participant has to obtain refusal of the remaining participants from enjoying their pre-emptive rights. Shareholders of a limited liability company are liable for obligations of such company only within the value of their shares.

Activities of LLC are regulated by Civil and Commercial Codes of Ukraine, as well as the Law on Business Entities. At the same time, most of provisions of the Law on Business Entities have become out-of-dated for which reason the new draft law “On the Limited Liability Companies and Additional Liability Companies” is elaborating so far, which entails absolutely new approach towards regulation of activities of LLCs. In particular, it provides a possibility for the participants to conclude corporate agreement enabling them to agree at their own discretion on voting at the general meeting, as well as on procedure of exercising pre-emptive right and share transfer, and many other issues. As another essential novelty introduced by the said Draft Law should be mentioned cancellation of existing prohibition to setting-off of debt of LLC before the participant on obligations of the latter to make contribution to the share capital of LLC (i.e. debt-to-equity swap mechanism), which is perceived to become effective tool for securing interests of creditors. Among other key novelties of the Draft Law:

- Introduction of statutory regulation of material and interested party transactions;
- Determining that the company's participant withdrawal from the company should be conducted only through the court procedure;
- Mitigating the risks of bad faith participants to block activities of the company;
- Introduction of possibility to establish supervisory board within the company;
- Elimination of limitation on the number of participants of the company (which for now is no more than 100 participants).

In order to register LLC a founder or its authorized person(s) shall provide a certain package of documents to the State Registrar, which includes resolution of the general founders meeting, charter of the company and information on the participants. Moreover, information on the beneficial owners of LLC shall also be discovered. The data on the company, including the name of beneficial owner(s), is publicly available through online access to the State Register.

LLC has two-tiered management system: highest body – general meeting of participants and executive body, which can either collegial (board of directors, management board) or individual (the director, general director). Although effective legislation is silent on whether LLC can have a supervisory board among its governing bodies, in practice business incumbents are establishing such governing body within a company, but only to extent that the charter contains comprehensive provisions on supervisory board, including procedure of appointment / termination of its members, competence and decision making. Establishing supervisory board can be necessary for the potential investors entering into the company to effectively supervise activities of the local management, and for this particular purpose the supervisory board is usually vested with powers to provide preliminary approvals for certain transactions to be conducted by executive body of the company: i.e. transactions exceeding certain thresholds (depending on the business scale and turnover of the company) or transactions of certain type (such as loan agreements, security agreements, etc.) and the like.

The highest governing body in LLC – a general meeting consists of participants or representatives appointed by them. Pursuant to Law on Business Entities it is a general rule that the general meeting has a quorum if the participants (their representatives) holding together over 50%+1 of the total amount of votes are present at the meeting. Nonetheless, there is a carve-out stipulating that, provided there is no state share in the company, the participants may set alternative quorum threshold (either below or above 50%+1, or even 100%).

In terms of voting arrangements, for ordinary issues the participants adopt a decision by simple majority (50%+1 of votes of those present at the meeting). There are, however, cases where qualified majority of votes are required, namely:

- 75% of votes of all participants of the company for: resolutions on alienation of the company's assets in the amount exceeding 50% of the aggregate assets value and decisions on liquidation of the company;
- 50%+1 of votes of all participants of the company for: determination of the company's business dimensions, amending the charter, approval of plans and reports on implementation thereof, and exclusion of participant.

Executive body is responsible for conducting day-to-day business activities of a company. Members of executive body can be appointed either from composition of participants, or not. According to the general rule, the competence of LLC's executive body is established based on residual principle: it covers all issues not falling within the competence of the general meeting. On the one hand, the participants can limit the powers of executive body to act on behalf of the company by setting certain thresholds or qualifiers in the company's charter.

Activities of executive body is supervised by an audit commission established by the general meeting out of their members in the number provided in the company's charter, but not less than 3 persons. In practice it is often impossible to establish the audit commission out of composition of shareholders (simply because there are less than 3 participants). Despite the above provisions, effective laws do not set any liability for non-compliance.

## • General Regulation on Limited Liability Companies

JSC is a type of legal entity with the authorized capital divided into specified number of shares of equal par value. Activities of JSCs are mainly regulated by the Civil Code of Ukraine and the Law of Ukraine "On Joint Stock Companies". There also the whole set of regulations adopted by the National Securities and Stock Market Commission of Ukraine relating to certain aspects of activities of JSCs (for example, procedure for issuance of shares or cancellation thereof, disclosure of information, procedure of reorganization of JSCs, etc.).

JSC may issue ordinary and preferred shares. Any issuance of shares, either initial or subsequent, is subject to registration with the National Securities and Stock Market Commission of Ukraine. In case a JSC fails to register the issuance of shares, any transactions conducted with non-registered shares are deemed void. Moreover, any transactions with the shares have to be conducted within depositary system, which means that the owner of shares shall have securities accounts opened in the custodian. JSC may exist in the form of either public or private company, whereat private JSC may conduct only private placement of shares and public JSC may conduct either private or public placement of shares. There is also a requirement for the public JSC to include its shares into the list of at least one stock exchange in Ukraine prior to 01 January 2018.

A minimum amount of authorized capital of a JSC is 1,250 minimum wages as of the date of incorporation of the company, which amounts approx. to EUR 128.000.

Corporate governance in JSCs is conducted by the shareholders' general meeting, acting as the highest governing body; supervisory board; executive body (the board of directors or individual director); and the audit commission (or a single auditor). Establishing of supervisory board within a JSC having less than 10 shareholders is not mandatory, in which case all functions of supervisory board are performed by the general meeting of shareholders.

A JSC is obliged to convene a general meeting on an annual basis (annual general meeting). The quorum of the general meeting shall be determined by the registration committee at the time of completion of the shareholders' registration. The general meeting is deemed quorate if the shareholders holding more than 50% of all voting shares are present at the meeting; no derogation from the rule is allowed. At the general meeting the votes are casted according to the principle one share – one vote, except for the cases of cumulative voting. Resolutions on ordinary issues are deemed duly adopted if voted by simple majority of votes, which is 50%+1 of votes of those present at the meeting. There are, however, issues requiring qualified majority of votes, namely:

- 75% of votes of all shareholders of the company for: amending the charter, cancellations of treasury shares, alteration of type of JSC (from public to private or vice versa), placements of shares, increase / decrease of charter capital, an termination and spin-off;
- Additional matters stipulated in the charter of private JSC.

The general meeting is not entitled to resolve the issues not included into agenda. Ballot papers may be used for voting on the agenda items of a general meeting. There are a number of formal requirements in the effective Law on JSC relating to procedure of convening the general meeting and voting at the meeting. Supervisory board is a governing body responsible for protection of interests of stockholders and, within competence determined in the charter and effective laws, is responsible for supervision and controlling activities of the company's executive body.

JSC with 10 or more shareholders is obliged to establish the supervisory board. Moreover, supervisory board of public JSC shall consist of no less than 5 members, whereat 2 shall be independent directors. Competence of supervisory board includes adoption of decisions on such matters as appointment and termination

of powers of members of executive body of the company, election of the company's auditor, preparing agenda of the general meeting, convening ordinary or extraordinary general meeting, redemption of shares, placement of securities by the company, approval of market value of assets, approval of material transactions, etc.

Executive body is responsible for conducting day-to-day business activities of a JSC. Its competence includes dealing with all issues related to the management of the company, except for those falling within competence of the general meeting or supervisory board. The executive body is accountable to the general meeting and the supervisory board and shall arrange implementation of their decisions.

In order to audit the financial and economic activities of a JSC the supervisory board may elect the audit commission (the auditor). The audit commission (auditor) shall be entitled to make propositions to the agenda of the general meeting and request convocation of an extraordinary general meeting. Members of the audit commission (auditor) shall be entitled to attend the general meeting, and participate in the discussion of the agenda with a deliberative vote. Members of the audit commission (auditor) shall be entitled to participate in the meetings of the supervisory board and the executive body, if this is provided by the company's charter or the by-laws.

JSCs shall disclose relatively large amount of information, including annual and quarterly reports, as well as special information upon occurrence thereof, via, inter alia, publishing it on the web-site.

## • General overview of foreign investments regulations

The Law "On Investment Activity" dated 18 September 1991 No. 1560-XII defines the forms and types of investment activities. It contains all major principles for conducting investment activities in Ukraine. In particular, an investment activity can be carried out with own or borrowed funds, budget appropriations in form of monetary funds, securities, real estate and movable property, intellectual property rights, know-how etc. The Law provides some guaranties for investors – guarantee of preservation of initial contractual terms against change of legislation worsening position of an investor, protection from interference of state agencies and officials, right to compensation of losses incurred as a result of acts of state bodies, guaranties for protection of investment against expropriation.

Quite recently (i.e. commencing June 2017) mandatory state registration of investments has been cancelled. Instead, a declarative principle of public accounting of investment is effective – which is the submission of statistical reports on the foreign investments that have already been made.

In order to stabilize domestic currency market, which became especially vulnerable during the years of 2015–2016, the National Bank of Ukraine introduced a number of foreign exchange restrictions, which makes it relatively complicated to effectively conduct divestiture shall the need arise. In particular, according to recent resolution of the National Bank:

- It is prohibited to repatriate the dividends, except for the dividends accrued for the years of 2014-2016. However, such dividends can be repatriated by foreign investor within one month in the amount not exceeding the equivalent of USD 1,000,000 or 10% of the total volume of such dividends to be repatriated. If such 10% is more than the equivalent of USD 5,000,000, the threshold sum of the dividends to be repatriated within one month will be the equivalent of USD 5,000,000;
- It is prohibited to purchase and/or transfer foreign currency in order to repatriate funds received by foreign investor from the transaction on the sale of corporate rights / shares it holds in the Ukrainian legal entities;
- Payments under export and import of goods operations shall be carried out within the period not exceeding 180 days;
- Mandatory sale of 50% of revenues from abroad in foreign currency.

Notwithstanding existing foreign exchange restrictions, it has been a clear message of the National Bank of Ukraine that it will pursue with liberalization measures of foreign exchange regulation, especially in the light of gradual recovery of the national economy. Moreover, the National Bank presented a draft Law on foreign currency that, according to regulator, is intended to overcome the complexity and over-regulation of foreign exchange regulation in Ukraine and lay down new principles underlying a new regulation.

## • Significant Novelties in Merger Control Regulations

On 18 May 2016 the law establishing increased notification thresholds has come into legal force, whereby the merger clearance is obligatory for the transactions meeting one of the two alternative set of thresholds as of the end of the year preceding the concentration:

- Euro 4 million in either assets or turnover in Ukraine for each of at least two merging parties, and euro 30 million either in assets or turnover worldwide for all the merging parties aggregately; or
- Euro 8 million in either assets or turnover in Ukraine for the target group (or one of the joint venture partners groups in case of joint ventures establishment), and euro 150 million in turnover worldwide for at least one other merging party (in most cases, – for the party acquiring control/ purchasing assets/shares/ stakes).

Apart from the above amendments, the law also envisages such important novelties as: elimination of market threshold; introduction of simplified procedure for transactions lacking effect on competition on the Ukrainian markets; introduction of preliminary consultations regarding simplified procedure application possibility; reduction of the number of reasons for in-depth investigation launch; clarification of remedies negotiation procedure, etc.

All the above shows that the Ukrainian market is now encountering substantial reformation of statutory framework in corporate law and foreign investments aiming at creating business friendly business environment with understandable and comprehensive rules both for domestic and foreign businesses.



- **Taxpayers**

Resident companies are taxed at their worldwide income. Non-resident entities are taxed at their business or trade income derived in the territory of Ukraine via permanent establishments or at other non-business and / or passive Ukrainian sourced income (“withholding tax”).

- **Corporate Profit Tax Base**

Taxable profit is calculated as a financial result before tax determined in the financial statements in accordance with the Ukrainian National Accounting Standards or IFRS, increased or decreased by the tax adjustments arising in accordance with provisions of the Tax Code of Ukraine (hereinafter – TCU). “Small” taxpayers with income not exceeding UAH 20 Mio (approximately EUR 666,700.00) for the previous tax period may opt not to apply the tax differences.

- **Corporate Profit Tax Rate**

The general corporate profit tax (hereinafter - CPT) rate is 18%. Specific CPT rates (0, 3, 10, 18, 30 %) are applicable to certain companies and to the profit or income from conducting certain businesses (for instance, to the profit from insurance or gaming activities). Non-residents, deriving income from Ukraine which is subject to CPT in Ukraine, are obliged to tax their income at the rates of 0, 4, 6, 12, 15, 20 % depending on the type of income.

0% CPT rate is applicable to the profits of Ukrainian resident-companies if such companies meet the specific criteria established by the TCU (the number of employees, the minimum salary of employees, types of activities etc.). This rate is established until 31 December 2021.

## • Taxation of Dividends

Incoming dividends received by Ukrainian-resident company from another Ukrainian-resident company are not subject to CPT at the level of recipient (except for dividends from collective investment vehicles and from CPT payers which profits are exempt from CPT in the amount of such profits) if such recipient applies tax adjustments. Otherwise dividends are included into the ordinary income of a CPT payer. Dividends received by Ukrainian-resident company from non-resident company are subject to 18% CPT.

Outcoming dividends are subject to an advanced CPT (ACPT) at the rate of 18% accrued on a gross basis and paid at the distributing company's cost. The basis for calculation of ACPT is the difference between the amount of dividends subject to distribution and the amount of profit for the tax year for which the dividends are distributed if such profit has already been taxed. The paid ACPT can be set off against future CPT liabilities of the distributing Ukrainian company. ACPT shall not be paid in certain instances, inter alia, if the recipient of dividends is individual.

## • Taxation of Capital Gains

Capital gains are generally included into the regular income and taxed at the standard CPT rate.

## • Participation Exemption

No

## • Incentives

The TCU prescribes a number of incentives for different types of businesses and transactions in Ukraine. As an example:

- Until the end of 2021, a 0 % CPT rate applies to the profits of taxpayers with annual income under UAH 3 million (approximately EUR 100,000.00) that are not engaged in cross-border activities (except for information technology), provided that certain additional criteria are met. This exemption does not apply to the taxpayers deriving income from certain sectors, including engineering services, services related to immovable property, legal or accountancy firms etc.;
- Until 1 January 2025, a temporary exemption from CPT is established for aircraft manufacturers meeting certain requirements;
- Organizations incorporated by NGOs of disabled people are exempt from CPT if they are granted a right to use this privilege by meeting several criteria stipulated by the TCU;
- Non-profit organizations are exempt from CPT if (a) they are included into the state register of non-profit organizations, and (b) their transactions meet specific criteria determined by the TCU.

## • Special Regimes

### UNIFIED TAX

Unified tax could be paid instead of CPT (by legal entities) or personal income tax (by private individuals or private entrepreneurs) by four groups of taxpayers at different rates and subject to different conditions (depending on their annual income, quantity of employed individuals and on the type of business). The tax rates for the groups No. 1–3 are the following: (1) for the group No.1 the tax rate is around EUR 5.50 per month; (2) for the group No.2 the tax rate is around EUR 21.00 per month; (3) for the group No.3 the tax rate is 3% (if registered as a VAT payer) or 5% (if non-VAT). Companies enjoying Unified tax regime are exempt from CPT and certain other taxes (including VAT except for certain instances).

### SIMPLIFIED TAX REGIME FOR AGRICULTURAL COMPANIES (Unified tax, group no.4)

Agricultural companies may qualify for a favorable tax regime in case income from realization of agricultural goods of own production constitutes not less than 75% of total annual income. Such taxpayers are exempt from CPT and certain other taxes. Instead they pay a Unified tax, calculated based on the type, size and location of a land plot. As of 1 January 2017, the rates vary between 0.19% and 6.33%.

## • Losses

No time limits are established for carry forward of tax losses. The TCU envisages certain restrictions for carry forward tax losses accumulated in the previous periods. Loss carryback is restricted.

## • Anti-avoidance rules

### TRANSFER PRICING

Transfer pricing (hereinafter – TP) rules are based on the OECD Transfer Pricing Guidelines with some local peculiarities. In Ukraine the TP rules came into force as of 1 September 2013 and undergone numerous changes. The TP rules apply to controlled transactions, namely:

- Business transactions with related non-residents
- As of 1 January 2017, transactions with certain non-resident entities which do not pay corporate profit taxes, and/or entities that are not tax residents of the countries where they are registered, according to the special list approved by Ukrainian Government
- Cross-border business transactions for the sale and/or purchase of goods and/or services through non-resident commissionaires
- Business transactions with non-residents registered in or which are residents of low-tax jurisdictions according to the list approved by Ukrainian Government

As of 1 January 2017 the above transactions are recognized as controlled only if the following conditions are simultaneously met:

- Total income of the taxpayer exceeds UAH 150 Mio (approximately EUR 5 Mio) for the relevant year, net of indirect taxes
- Volume of transactions with a particular counterparty exceeds UAH 10 Mio (approximately EUR 340,000.00) for the relevant year, net of indirect taxes

To comply with transfer pricing legislation, controlled transactions must be conducted at arm's length range. A country-by-country reporting has not yet been implemented in Ukraine.

## • Deduction restrictions (for CPT purposes)

There are a number of restrictions to deduct expenses for the purpose of calculating CPT; some of those are provided below (the list is not exhaustive):

- Deductibility of payments for goods and services supplied by a resident of a low-tax jurisdiction is limited to 70 % unless the price is confirmed by TP documentation;
- Deductibility of royalties paid to a non-resident is limited to the income from royalties increased by 4 % of such taxpayer's net income for the previous tax year;
- No deduction is allowed for royalties paid to (i) non-resident which is not a beneficial owner, (ii) non-resident which is exempt from tax on royalties in its jurisdiction of residence, (iii) non-resident for the intellectual property objects the rights for which originate from Ukraine, etc.

**There are a number of other restrictions on deduction of expenses for CPT purposes. However all these restrictions are only applicable to CPT payers applying tax differences.**

## • Thin capitalization rule

For CPT purposes the financial result before tax shall be increased on any excess of the interest accrued on loans, borrowings and other debt obligations with non-resident related parties over 50% of EBITDA of the taxpayer, where the amount of debt obligations of such taxpayer arising from transactions with non-resident related parties exceeds more than 3,5 times (10 times for financial and leasing companies) the amount of taxpayer's net assets. Non-utilized interest expenses are carried forward to the following tax periods subject to certain special rules. This restriction is only applicable to CPT payers applying tax differences.

## WITHHOLDING TAX

Withholding tax applies to Ukrainian sourced income paid to non-resident by a resident of Ukraine or by a permanent establishment of non-resident except for income from the supply of goods, works, services. The general withholding tax rate is 15% unless a lower rate is set forth by a relevant double tax treaty. Other tax rates are set forth for specific types of income. Withholding tax applies to dividends, interest, royalty, capital gains, lease payments, investment income, agency and commission fees, freight, engineering and advertisement fees, insurance premiums and certain other income.

# Ukraine | VALUE ADDED TAX

## • Taxable Transactions

The supply of goods and services within the customs territory of Ukraine as well as import and export of goods are subject to VAT. Supplies of specific goods and services are exempt from VAT, including, but not limited to supply of baby food and goods, some educational services etc. As an example the following transactions are not subject to VAT (the list is not exhaustive):

- Issue, placement and sale (redemption) of securities and corporate rights for monetary payments;
- Insurance, coinsurance and reinsurance services;
- Reorganization of legal entities, etc.

## • Value Added Tax Rate

The standard rate of VAT in Ukraine is 20%. Certain transactions are taxed at a zero rate e.g. export transactions. A reduced 7% VAT rate is applicable to import and supplies of certain medicinal products, devices and equipment according to the list approved by the Government of Ukraine.

## • Registration

Compulsory VAT registration is set forth for resident companies, private entrepreneurs and permanent establishments of non-residents whose volume of VAT-able transactions for the last 12 months exceeds UAH 1 Mio (approximately EUR 33,350.00). There is no obligation of compulsory VAT registration for a non-resident without a permanent establishment in Ukraine. In case the above criteria are not met entity person may apply for VAT registration voluntarily.

## • Filing

VAT invoices must be electronically registered with the Unified Register of VAT Invoices.

## • Incentives

VAT exemptions are envisaged, for instance, for the aero and space, coal, filmmaking, IT, paper waste and metal scrap recycling industries etc.

# Ukraine | REAL ESTATE TAX

## • Taxpayers and Tax object

Real estate (other than land) tax became effective as of January 1, 2013 and is imposed on owners of residential and non-residential real estate and its portions, both individuals and legal entities, including non-residents. The TCU stipulates certain exceptions from the real estate tax for following kinds of property:

- State-owned residential and non-residential property, as well as such property owned by local authorities and non-profitable organizations maintained for the costs of state (local) budget;
- Residential and non-residential property located at exclusion areas stipulated by law;
- Residential property owned by large families with five or more children.
- Residential property declared uninhabitable by local authorities due to its emergency conditions;
- Non-residential property used by SME's for the purpose of conducting economic activities (Small Points of Sales);
- Facilities of agricultural producers used for agricultural activities;
- Residential and non-residential property owned by organizations of disabled persons and enterprises owned by such organizations;
- Property owned by religious organizations acquired within the charter purposes except for the property used for economic activities;
- Residential property owned by socially vulnerable children;
- Non-residential real estate which belongs to non-profitable state or municipal enterprises for the health rehabilitation of the children;
- Non-residential real estate which belongs to non-profitable state or municipal enterprises for the sports education of the people;
- A separate list of non-residential property which is used for Olympic and Paralympic preparation of the sportsmen;
- Family-type orphanages;
- Industry facilities;
- Educational facilities;
- Dormitories;

## • Tax base

The total area of a respective facility is considered to be a tax base for the purpose of assessment of real estate tax. If a taxpayer owns several real estate objects the tax base shall be calculated with respect to each individual object.

According to the TCU, there is a tax exemption for residential properties, owned by the individuals: 60 square meters of an apartment and 120 square meters of a house (non-taxable area) are exempted from taxation. This exemption could be utilized once in a calendar year. If a taxpayer owns several residential properties (incl. apartments and houses) the maximum non-taxable area will amount to 180 square meters.

## • Tax rate

The tax rates are set forth by decisions of local authorities depending on real estate object's location, however the rates per one square meter could not exceed 1,5% of the minimum wage established by the laws of Ukraine as of 1 January of a reporting (tax) year for 1 square meter. Considering the currently effective minimum wage (UAH 3,200.00, approximately EUR 100), the maximum rate of real estate tax shall amount to UAH 48.00 (approx. EUR 1.50) per square meter.

For apartments with an area exceeding 300 square meters and/or houses with an area exceeding 500 square meters, the tax shall be increased by UAH 25,000.00 (approx. EUR 833.00) for each of such property or part of it per year.

## • Tax Payment Procedure

The real estate tax is paid by the taxpayers once a calendar year. The tax amounts for individuals are assessed by tax authorities; a tax assessment notice with the amount of real estate tax should be received by the taxpayer by 1st of July of the year following the year for which the tax is paid.

Legal entities are obliged to assess the tax amount in advance and file the tax return till 20th of February of the year for which the tax is paid. The tax amount herewith should be divided into the equal parts and paid in separate settlements on a quarterly basis.



# Ukraine | INDIVIDUAL TAXATION

## • Taxpayers

Resident individuals are taxed on their worldwide income; non-residents are taxed on their Ukrainian-sourced income.

## • Residency

Tax residency is determined based on the following tests (each subsequent test is applied if the previous test could not be applied):

- An individual is deemed to be a Ukrainian tax resident if he or she has a permanent place of residence in Ukraine;
- In case it is not possible to determine the residency applying the above criteria an individual is deemed to be a tax resident of Ukraine if he or she stays in Ukraine more than 183 days cumulatively during a calendar year;
- If an individual has a permanent place of residence also in a foreign country he or she is deemed to be a resident of Ukraine in case having more close economic and personal ties (center of vital interests) in Ukraine;
- In case it is not possible to determine the residency applying the above criteria an individual is deemed to be a tax resident of Ukraine if he or she is a citizen of Ukraine.

## • Personal Income Tax Rate

Basic personal income tax (hereinafter - PIT) rate amounts to 18 %. Specific PIT rates (0, 5, 9 %) are applicable to specific types of income (for instance, certain types of dividends; certain income received as an inheritance, etc.).

## • Military Contribution

A temporary military contribution on personal income of individuals, introduced in August 2014 and originally due to expire at the end of 2014, will now be levied until the reform of the Ukrainian armed forces is completed. The military contribution is levied on worldwide income of resident individuals and on Ukrainian-sourced income of non-resident individuals. The rate is 1.5% of taxable income in the form of salary, other incentive and compensatory payments and other benefits and remuneration accrued in connection with employment relations and under civil law contracts. Employers and other legal entities act as tax agents for withholding purposes. If there is no tax agent, the taxpayer must declare and pay the military contribution by himself.

# Ukraine | REAL ESTATE LAW

In accordance with the legislation of Ukraine the term “real estate” is defined as land plots and the property located on land plots which cannot be relocated without its depreciation or changing its purpose.

A land plot is a part of the earth’s surface with fixed boundaries, exact location and the defined rights attributed to it. The freehold (ownership) covers, within the boundaries of a land plot, the surface (soil) layer and water bodies, forests and perennial plantations located on such land plot, unless otherwise provided by law and provided that it does not affect third parties’ rights, as well as the space above and beneath the surface for the height and depth necessary for construction of buildings.

Based on the above definition, to qualify for real estate, the property (if other than land) should have a foundation and should be inseparably attached to a land plot, so that it cannot be removed from a land plot without its depreciation or changing its purpose.

The following types of property do not fall within the category of real estate as they do not meet all the requisite qualifications: temporary constructions, small architectural forms, non-capital facilities situated on the land plot (stationary outdoor advertising), facilities which are appurtenant or constituent part of another item e.g. pipe lines, automobile roads, power supply and heating networks, railroad tracks. . At the same time, an integrated property complex of an enterprise is treated as being equivalent to real estate. As for the construction in progress, its disposal as a real estate property can be carried out only after its commissioning and registration of title to such construction as a completed construction project in accordance with the legislation of Ukraine.

## • Rights to Real Estate

In Ukraine, a building and the underlying land plot is subject to a separate legal treatment. The Ukrainian legislation defines the following types of rights to real estate:

- **In respect of a land plot:** ownership (private, state and communal), lease, permanent use, emphytheusis, superficies, and servitude;
- **In respect of other real estate:** ownership (private, state and communal), lease, right of operational management, right of full economic use, and servitude.

The right of ownership to a land plot includes the right to own, use and dispose a land plot. Land lease is a contract-based possession and use of a land plot required by a lessee for conducting commercial and other activities for a defined period and in consideration for an agreed payment. A leased land plot can be further sublet by a lessee to a third party upon prior consent of a landlord.

The right of permanent use of land is the right to possess and use the land plot being in state or communal ownership without limitation of the term of use. The entities which are currently entitled to have the right of permanent use of a land plot can be divided in few main groups: (1) enterprises, institutions and organizations being in state or communal ownership; (2) Ukrainian non-profit organizations of disabled persons, their enterprises, institutions and organizations; and (3) religious organizations of Ukraine for the construction and servicing of religious or other buildings necessary for supporting their activities, (4) higher education establishments (irrespective of form of ownership).

Land servitude is the right of an owner or a user of a land plot to use third party's land plot either for free or on a chargeable basis for pass, laying out cables, electricity transmission lines etc. Land servitudes can be either permanent or temporary. The existence of land servitude does not entail the seizure of a land plot or termination of owner's title to it. Emphytheusis is the right to use a third party's land plot for agricultural purposes, while superficies means the right to use a third party's land plot for construction purposes. Emphytheusis and superficies are rarely applied in practice. In contrast to ownership and lease which are applicable to both land and other real estate, the right of operational management and the right of full economic use are normally related to buildings and constructions and are

mainly applied within structuring of state, local authorities and their subordinate companies' activity. The right of operational management of state or municipal property may be granted to state and municipal institutions and organizations, which do not conduct commercial activity; for instance, ministries, local state administrations, government agencies, etc. An organization or institution which holds real estate property on the right of operational management is not entitled to dispose of it with the intention of gaining any profits. The respective ministry or department, acting on behalf of the state or local community, exercises control over the use of the granted property and they may withdraw the property from the operational management if property is used in breach of its designated purpose.

The right of the full economic use is defined by the Commercial Code as the right of an entity that possesses, uses and disposes of the property assigned to it by the owner (or its authorized representative), with the limited authority to dispose of certain types of the property with the owner's prior consent only. The right of the full economic use is provided to the state owned or municipal enterprises for the purposes of their commercial activities. The owner of the property exercises direct or indirect (i.e., through its authorized representative) control over the use and management of the property without interference in the day-to-day business activities of the enterprise.

## • Registration of Proprietary Rights to Real Estate

Since the beginning of 2013, a new system of registration of real estate rights has been enacted in Ukraine. The essence of the reform lies in the introduction of a unified State Register of Proprietary Rights to Real Estate (hereinafter – 'Register'), which contains records on all registered rights to real estate and their encumbrances, and replaces the former multiple registers with fragmented information on property title. One of the most important features of the Register is its publicly access upon the person's registration and verification of personal data.

The State Register is maintained by Ministry of Justice of Ukraine. Registration of rights to real estate property is performed by state registrars acting within state enterprises such as state and municipal Administrative service centers and by notaries. Despite of the fact that state registrars and notaries have almost the

same powers there are few peculiarities of its implementation. Thus, state registrars are exclusively allowed to register the title to newly-created property. Notaries perform functions of state registrars while certifying a property deed, which allows simultaneous conclusion of an agreement and registration of the respective title. Under the Ukrainian legislation the following rights and encumbrances are subject to compulsory registration: ownership right, servitude, emphyteusis, superficies, right of economic use and operational management, lease (if the lease term exceeds three years), right of permanent use of land, mortgage, trust management as well as other proprietary rights, tax lien and other real estate encumbrances.

The right of ownership to a real property or a land plot arises upon its state registration with the Register. The state registration of all rights to land is carried out after the state registration of land with the State Land Cadaster. Data regarding owner, lessee, area and designed purpose of all land plots registered in State Land Cadaster is publicly available via Public Cadaster map of Ukraine. All the proprietary rights to real estate duly registered with previous registers (before 2013) and those, which had not to be mandatory registered under the previous legislation, remain valid.

## • The Principle “Land Follows the Property”

The past years saw the general trend toward the gradual implementation of the principle “Land Follows the Property”. In pursuance of the above principle, the amendments have been adopted to both the Civil Code and the Land Code to the effect that the indication of the cadaster number and the total area of a land plot are qualified as the material term and condition of an agreement for alienation of a building located on such land plot (except for multifamily apartment buildings). The principle “Land Follows the Property” is further supported by the amendments introduced to the Civil Code, the Land Code as well as the Law “On Land Lease”, which can be summarized as follows. In case of acquisition of title to a building, a freehold or leasehold of the owner of such building in respect

of the underlying land plot terminates. The freehold of the land plot or part of it underlying the property passes to an acquirer without change of its designated use. Where the underlying land plot is not a freehold, but is rather leased, the new owner acquires such right of land use in the same scope and on the same terms and conditions as available to the former land user (lessee). Where an acquirer is not entitled to own land under Ukrainian law, it acquires the right of land lease instead. Despite certain promising signs of the “automatic” transfer of land following the property, the above principle does not work properly yet. As before, the parties would have to comply with the ordinary formalities and procedures to execute the transfer of title to land. The abovementioned principle is hardly applied with regard to state and municipal land which was leased by the previous owner of property due to specific procedure of leasing state and municipal land and termination of such lease relations.

## • Restrictions on Foreign Ownership to Land

In accordance with the legislation of Ukraine, foreign legal entities, foreign citizens and joint ventures with foreign participation may purchase and lease buildings, constructions and their parts as well as lease both agricultural and non-agricultural land plots equally to Ukrainian citizens and legal entities without foreign participation. However, they may purchase land plots only according to the procedure and with limitations set out by the Land Code. Foreign individuals, foreign entities and foreign states are prohibited from acquiring agricultural land into private ownership. As far as non-agricultural land is concerned, foreign citizens and stateless persons are entitled to purchase non-agricultural land plots within residential areas without limitations and non-agricultural land plots outside residential areas only if such persons own real estate located on such land plots.

Foreign entities and joint ventures may only acquire land into ownership (i) within residential areas if they acquire real estate for construction of the property involved in the commercial activities; or (ii) outside residential areas if they purchase real estate.

State or communal land may be sold to a foreign legal entity provided also it establishes and registers its permanent establishment in the form of a commercial representative office in Ukraine. State-owned non-agricultural land is sold by the Cabinet of Ministers of Ukraine, subject to the prior approval of such sale by the Ukrainian Parliament. Communal nonagricultural land is sold by the relevant municipal authorities, subject to the prior approval of such sale by the Cabinet of Ministers of Ukraine. The legislative guidance on the procedure for the obtaining

of approval of the Cabinet of Ministers is lacking. In practice, the obtaining of such approval appears lengthy and complicated. Those state-owned lands underlying the property which is subject to privatization may be sold to foreign legal entities by a state privatization body upon approval of the Ukrainian parliament.

Please note that any land plot which is in state or communal ownership as well as the rights to it (lease, superficies and emphyteusis) should be sold on a competitive basis (at a land auction) subject to the extended list of exceptions. For example, when a land plot is underlying building owned by an individual or a legal entity, or a land plot is granted for subsoil use and special water use pursuant to a special permit (license), etc.

From the effective risk management perspective, investors are often recommended to consider a “two-tier” structure. Under this structure, which has become quite common in Ukraine, a “first-tier” Ukrainian subsidiary company is created, whether (i) fully owned by a foreign legal entity or a foreign natural person, or (ii) jointly owned by foreign and Ukrainian legal entities or natural persons. The “first-tier” subsidiary company would then establish a “second-tier” Ukrainian subsidiary company. Because the “second-tier” entity will directly involve a Ukrainian founder(s) only, it will not qualify for a foreign legal entity or a joint venture under the Land Code and, consequently, it will not be subject to the above restrictions while acquiring land in Ukraine.

When structuring acquisition transaction, the following important requirement should also be considered. The Civil Code expressly prohibits the establishment of the consecutive chain of two sole shareholder companies, i.e. a sole shareholder company cannot found another sole shareholder subsidiary company. Therefore, the “first-tier” subsidiary must be founded by at least two shareholders to enable the establishment of the “second-tier” legal entity with a sole participant. Alternatively, the “second-tier” subsidiary company must be founded by at least two participants, if the “first-tier” subsidiary company has a sole participant.

## • Land Moratorium

An important factor preventing the development of the land market in Ukraine is the temporary moratorium on alienation of agricultural land plots. However the moratorium is set not for all kinds of agricultural lands. In particular the following kinds of agricultural lands are not subject to alienation – commercial agriculture lands, personal farming lands (for land shares owners) and land shares. All other kinds of agricultural lands such as subsidiary farming lands, individual and



collective gardening lands etc. can be alienated under Ukrainian legislation. Firstly introduced in 2001 the moratorium was initially planned to remain in force for five years – considered a reasonable period in order to properly prepare a legislative and institutional framework essential for the establishment of a well-governed land market. However, it has been extended several times and for now members of Parliament extended the moratorium until the adoption of the law on agricultural land turnover, but not earlier than January 1, 2018.

According to the wording of the governmental draft Law “On Agricultural Land Turnover” it is likely that foreign investors will not be allowed to directly invest in Ukrainian agricultural land, thus the only available option will be lease.

- **Escrow**

The concept of escrow account has been introduced in Ukrainian law very recently, which is a major development.

The Escrow mechanism allows Ukrainian banks to keep the funds in the client’s special (escrow) account (the client or a third party may transfer the funds to the account) until said funds have been released, upon certain agreed conditions (stipulated in the transaction), for the benefit of the client or a third party beneficiary. The release is made against the submission of documents confirming fulfillment of the agreed conditions. Unless otherwise provided by the escrow agreement, the bank should only assess the external characteristics of the documents submitted. Until release the funds in the client’s special (escrow) account are frozen and neither client nor third party beneficiary may dispose of the funds.

## • Acquisition of real estate

There are two forms of real estate acquisition: a direct purchase of real estate (“asset deal”) or acquisition of shares in the company holding real estate (“share deal”). In choosing the preferable form of real estate acquisition, the following advantages and disadvantages of each option should be considered.

The main advantage of an asset deal is that the purchaser acquires a specific asset and it does not succeed to any debts and liabilities of the seller. Additionally, the registration of the property title is carried out simultaneously with the conclusion of the respective agreement. The disadvantages of an asset deal:

### The disadvantages of an asset deal are:

- It is necessary to re-register the right of ownership to the real estate property
- Increased transactional costs (state notary fees and payment to the State Pension Fund, does not apply in the case of land sale) amount to 1% + 1%
- In the case of the sale of a real estate property which is built on a leased land plot, a land lease agreement will not be automatically assigned to the new owner of such real estate property. Upon transfer, a land lease agreement should be concluded with the new owner
- The purchase price is subject to VAT (save for the sale-purchase of land which is not subject to VAT)
- Ukrainian law is applicable to the agreement as the property is located in Ukraine
- In the event of sale of a land plot, construction documents and other permits for construction activities on a land plot may not be automatically transferred to the new owner. Respective documents should be re-registered for the new owner
- Restrictions for foreign capital in respect of land relations

### The advantages of a share deal are:

- A relatively fast procedure for registration of documents necessary for transfer of ownership to a participatory interest (share)
- VAT does not apply
- An offshore exit is possible
- A foreign governing law and foreign arbitration may be considered
- It is not necessary to re-register the ownership title to the real estate property
- No restrictions for acquisition by foreign investors
- Land lease agreements, licenses, building permits, project documentation and licensing documentation for an investment project remain in force and do not need to be re-executed
- Relatively low transaction costs

### The disadvantages of a share deal are:

- All the liabilities and debts of the target company are transferred to the purchaser
- Acquisition may require a prior permit from the Antimonopoly Committee of Ukraine

# Ukraine | LABOUR LAW

The Ukrainian legislation deals with employees in general, making no distinctions based on their positions (with some minor exceptions). The Labour Code of Ukraine dd. 10.12.1971 is the principal legislative act governing employment relations in Ukraine. However, a number of its provisions are elaborated in the subordinate legislative acts. The specification of working conditions, remuneration and social privileges are commonly left to collective bargaining agreements provided that the agreements do not limit the guarantees established for employees, by law. The following defines some principal requirements vis-à-vis labour relations, established by the Labour Code and other legislative acts.

- **Working Hours**

Working hours may not exceed 40 hours per week. For certain categories of employees, the working week is established at the level of 36 or 24 hours and for some categories irregular working hours are allowed. Overtime work is allowed by the legislation only in exceptional cases and may not exceed four hours within two days on the row or 120 hours per annum and is compensated at double rates.

- **Time Off**

Employees are allowed to have breaks for resting and taking meals which last up to two hours. The breaks are not included into the working time. By a five-day working week employees have two days-off, and by a six-day working week – one day-off. The usual day-off is Sunday.

If a public holiday or a free day concurs with a day-off, the day-off is postponed to the next working day after such public holiday or a free day. In general, no work shall be done on daysoff. It is allowed in exceptional cases that single employees work on such days.

Work on public holidays is allowed in exceptional cases according to the legislation. Work on public holidays is remunerated in double amount. Upon request of an employee he/she can also get another day-off. Work on days-off is remunerated either in double amount or by giving another day-off (mutual consent is required).

## • Vacation and Holidays

Statutory paid annual vacation is 24 calendar days. For certain categories of employees the law provides for a longer vacation period or additional vacations, including social one. In case of dismissal of an employee he/she receives a monetary compensation for all unused days of the annual vacation and the additional vacation for employees with children. There are some additional vacation types in Ukraine, for example:

- Additional annual vacation for work under arduous and harmful work conditions
- Additional annual vacation for the participants of military actions, persons disabled of war
- Maternity leave
- Additional annual vacation for special work nature
- Additional study vacation
- Childcare leave up to three years of age
- Additional vacation for employees with children
- Additional annual vacation for employees with children under the age of 15 or adult child of type A, group I of disability
- Research leave
- Adoption leave
- Unpaid vacations

## • Salaries and Wages

The salary amount should be established by an individual employment agreement with an employee. The minimum monthly salary for unqualified labour may be no less than the threshold established by the labour legislation (currently UAH 3200.00). The minimum salary does not include such additional payments as payments for night work or overtime work, work in unfavorable working conditions and in increased risk for health, itinerant work, bonuses for holidays and anniversaries. The salary is subject to personal income tax that is presently levied at the rate of 18%. Salaries are paid in Ukrainian currency at least twice a month.

- **Guarantees and Compensation Payments**

The labour legislation stipulates cases in which employees are entitled to salary even if they did not perform their work under the labour agreement – guarantee payments. Such payments are provided for employees in elective offices, donors, employees sent to qualification courses during working hours and some other categories.

Compensation payments are such remunerating expenses of an employee, which are connected to performance of the labour duties (in case of transfer, assignment to work in another region, business trips, amortization of tools owned by an employee for needs of an enterprise etc.).

- **Pension and Social Insurance**

The employer is required to make obligatory payments to the State Pension Fund on behalf of employees. The rate of the unified social security contribution is 22 % of an employee's remuneration (is paid by the employer). Any other social insurance (voluntary) is left to the employer's consideration.

- **Employment of Foreigners**

Foreign nationals may be employed by Ukrainian employers subject to prior obtaining of the Ukrainian work permit according to the procedure, established by legislation. A work permit is issued as a rule for one year and is subject to renewal.

## • Disabled Persons

The current legislation of Ukraine provides a quota of work places for disabled persons in the amount of 4% of the average number of employees per annum or, if there are 8-25 employees, in the amount of one work place.

## • Activity of Trade Unions

Citizens of Ukraine are entitled to participate in professional unions in order to protect their labour, social and economic rights and interests. A trade union is a voluntary, non-profitable non-governmental organization of citizens united by mutual interests by the nature of their professional (labour) activity (study). Trade unions are established in order to represent, exercise and protect labour, social and economic rights and interests of their members and can have a status of primary, local, district, regional, republican, or all-Ukrainian. Foreign citizens and stateless persons are not allowed to establish trade unions, but are entitled to join them, if this is provided by their statutes.

## • Collective Bargaining Agreements

A collective bargaining agreement is concluded in order to regulate production, labour, social and economic relations and to coordinate interests of employees, owners and their authorized bodies. In a newly established enterprise a collective bargaining agreement shall be concluded upon initiative of one of the parties within 3 months after registration of the enterprise and shall be preceded by collective bargaining negotiations, in which both parties of the collective bargaining agreement shall participate.

There is no liability for lack of collective bargaining agreements, only for avoiding negotiations as to their conclusion. A collective bargaining agreement signed by the parties is subject to a notifying registration by the local state authorities. Any changes or amendments to a collective bargaining agreement shall be registered pursuant to the procedure for registration of collective bargaining agreements.

## • Labour Agreements

Under a labour agreement the employee obliges to work as provided by the agreement with adherence to the internal labour policy, and the employer obliges to pay the employee for the work and to ensure labour conditions necessary for work and as provided by the labour legislation, collective agreement and agreement of the parties.

It is not obligatory in Ukraine to conclude labour agreements in writing, except for some categories of employees (minors, work under some special conditions etc.) and in case if an employee insists on concluding the labour agreement in writing.

Terms of labour agreements which make the position of employees worse compared to the current legislation are null and void. Even though an employee may agree to such conditions, they may not be applied. A labour agreement may be concluded for an unlimited period of time, fixed-term or concluded for the period of execution of certain works. The laws of Ukraine prohibit unreasonable refuse in conclusion of a labour agreement (employment).

## • Labour Contract

A labour contract is a special labour agreement form for certain categories of employees where its validity term, rights and obligations of the parties (including material liability), financial conditions and organization of the employee's work, contract termination terms, including early termination, may be stipulated pursuant to the parties' agreement. Contracts are to be made in writing.

The laws of Ukraine directly stipulate the exact list of employees with whom the labour contracts may be concluded, for example scientists, employees of collective agricultural enterprise, directors of companies, policemen, teachers etc.

If the current legislation does not stipulate any possibility for contract conclusion in the respective case, the owner and the employee are not entitled to conclude the contract even upon their mutual consent.

## • Documents to be provided for employment

At conclusion of a labour agreement the future employee shall provide the following documents:

- Passport or any other ID;
- Labour book;
- A health status certificate (in cases provided by the legislation for workers on heavy, harmful and hazardous jobs and annually for persons younger than 21);
- Copies of child birth certificates (if the employee is entitled to child care privileges and guarantees).
- A copy of the individual tax number (for taxation purposes in regard to employee's salary);
- A document on education (in cases provided by the legislation);
- A copy of the social insurance card;
- Military registration document;

The Labour Code prohibits requiring provision of documents which are not stipulated by the legislation as well as of information on employee's party membership or nationality, domicile or temporary residence registration etc. Refusal in employment due to non-submission of documents not provided by the legislation is deemed to be unreasoned and is prohibited.

## • Employment Order

After agreement on work conditions with a potential employee, employment application submission, and in some cases conclusion of a labour agreement or contract in writing, an employment order shall be issued.

There is a standard approved form of the employment order, but in practice another more simple form of the order is used. The employment order is signed by the executive officer or any other authorized person. The employee reviews and signs the order. On the basis of the order an entry is made in the labour book.

The employee cannot be admitted to work without labour agreement set up by the employment order and without notification on employment sent to central executive authority that establishes and implements state policy on administering of single social contribution (currently tax authority).



## • Employer's actions before employee's admission to work

Before admission to work pursuant to the labour agreement the owner (an authorized body):

- Explains to the employee his/her rights and obligations and informs his/her on work conditions, any harmful or hazardous production factors at the work place and possible consequences for the health, his/her rights and privileges for work remuneration according to conditions set out by the legislation and the collective agreement
- Provides to the employee for reviewing the internal labour regulations and the collective agreement;
- Instructs the employee on safety and fire safety rules
- Assigns the employee with a work place and provides all tools and accessories necessary for work

## • Probation period by employment

In order to determine whether the employee complies with the work at the beginning of his/her employment, a probation period is established for the employee upon agreement of the parties. Probation cannot be applied to such persons:

- Persons under age of 18
- Young employees after graduation from career scientific-educational institutions
- Young professionals after graduation from higher educational institutions
- Persons retired from military or alternative (non-military) service
- Disabled persons sent to work pursuant to recommendations of a medical and social expert examination
- Seasonal and temporary workers
- Workers in case of employment in other region or transfer to other enterprise, institution, organization, transfer to other position within the same enterprise
- Persons designated to a position
- Winners of the competitive election for a vacant position
- Persons who have passed internship with separation from the main work when hiring
- Pregnant women
- Single mothers with children under the age of 14 or with disabled children;
- Internally displaced persons
- Persons who are to conclude a labour agreement of up to 12 month duration
- In other cases, provided by the legislation

There is no need to record information on employee's probation period in the labour book. During the probation period the employee has all the rights and all the obligations provided by the labour legislation. The only exception is an additional reason for dismissal of the employee as such who did not pass the probation period.

- **One month** – for workers (at this, in order to define the term “worker” the Occupational classification shall be used)
- **Three months** – for any other employee categories
- **Six months** – in certain cases upon agreement with the trade union committee

## • Change of essential working conditions

According to the Ukrainian legislation in case of changes in production and labour organization it is possible to change the essential work conditions (system and amount of payments, privileges, work regime, establishment or cancellation of part-time work, professions overlapping, change of categories or name of positions etc.). In such situation the employer shall provide respective employees with a two months prior notice before the changes come into force. If the previous essential work conditions cannot be preserved and the employee does not agree to continue work under the new conditions, the labour agreement shall be terminated.

## • Termination

Generally, employment relations, established for a definite period of time terminate after the employment term has expired. Employment relations, established for indefinite period, may be terminated by employee at any time by giving two weeks prior notice. Employers may terminate employment only in limited circumstances enumerated by the Labour Code. The labour legislation of Ukraine provides following reasons for termination of a labour agreement:

- Agreement of the parties
- Transfer of the employee upon his/her consent to another enterprise or to an elective office
- End of the labour agreement term, except for cases when labour relations actually continue and neither party demands their termination
- Refusal of the employee to be transferred to work in other region together with an enterprise as well as refusal to continue work due to change of the essential work conditions
- Call or enrolment to military service, assignment to alternative service
- Coming into force of judgment pursuant to which the employee is sentenced to imprisonment or any other punishment excluding possibility to continue work

- Reasons as provided by the labour contract;
- Employment in violation of the requirements of the Law of Ukraine "On Preventing Corruption" established for persons who have retired or otherwise ceased activities related to the exercise of state or local government functions during the year from the date of such termination;
- Reasons as provided by the Law of Ukraine "On Lustration";
- Reasons as provided by other laws;
- Upon employee's initiative;

► **Upon employer's initiative:**

- Change in production and work organization, including liquidation, reorganization, bankruptcy or conversion of the enterprise, decrease of the personnel number or the staff
- Determined employee's inconsistency with position or work due to insufficient qualification or health condition hindering continuance of such work
- Systematic non-performance of duties stipulated by the labour agreement or the internal labour order without reasonable excuse if disciplinary penalties have been previously imposed on the employee
- Appearance at work under alcohol, drugs or toxic influence
- Nonappearance at work during four months on the row due to temporary disability, except for maternity leave, if the legislation does not stipulate longer period of work (position) preservation for certain illnesses. If an employee has lost its ability to work because of a labour injury or a professional illness, his/her place of work (position) shall be preserved for the period of rehabilitation or assessment of disablement
- Reinstatement at work of the employee who previously performed this work
- Employment under subordination to an immediate relative in violation of the requirements of the Law of Ukraine "On Preventing Corruption"
- Stealing at work place (including petty theft) of employer's property determined by the court decision which came into force or resolution of a body authorized to impose administrative penalties or apply measures of public influence
- Call or mobilisation of employer – individual entrepreneur during the special period
- Single gross violation of labour relations by the director of an enterprise, institution, organization of any ownership form, his/her deputy, head accountant of an enterprise, institution, organization, his/her deputy, or officials of the customs service, state tax inspections with special ranks and officials of the state supervision and auditing service and bodies of the state price control
- Determination of employee's inconsistency with work within the probation period
- Wrongful acts of directors of enterprises, institutions, organizations which caused delay in payment or payment of lower amounts of salary compared to minimal wage as stipulated by the legislation
- Wrongful actions of the employee working with monetary values or merchandise if such actions lead to loss of employer's trust
- Immoral actions of educational personnel inconsistent with such work
- Truancy (including absence from work for more than 3 hours within business day) without a reasonable excuse
- Termination of authorities of corporate executives.

It is prohibited to dismiss certain categories of employees such as pregnant women, women with children under the age of three and single mothers with children under the age of 14 or with disabled children, except some cases regarding the companies' liquidation with the obligatory subsequent employment. An employee is entitled to receive a one-month severance payment (or more, if provided for in the collective agreement) when dismissed upon the initiative of the employer for particular reasons.

An employee is entitled to receive a one-month severance payment (or more, if provided for in the collective bargaining agreement) when dismissed upon the initiative of the employer for particular reasons. If the owner violates labour legislation, collective bargaining or labour agreements, the employee is entitled to receive at least a three-month severance payment (or more, if provided for in the collective bargaining agreement) during dismissal for such reasons. If the authorities of a corporate executive are terminated by the owner (what is possible anytime without giving any reasons), the severance payment amounts to at least six month average salary of such an executive.

## • Suspension from work

In certain cases the employer is entitled to suspend the employee from work:

- If the employee appears at work under influence of alcohol, drugs or toxins
- If the employee refuses or avoids obligatory medical examination, training, instructions and attestation in labour protection and fire safety
- In other cases stipulated by the legislation

Suspension means that during a certain period of time the employee is not admitted to work which he/she is obliged to perform under the labour agreement. At this, labour relations and the labour agreement shall not be terminated.

After the end of the suspension term the employee may be admitted to work, transferred to another work, brought to a disciplinary liability or dismissed.

Members of the executive body of a company may be at any time suspended from performance of their duties if statutory documents of the company do not stipulate reasons for their suspension. A suspension of executive body members (including head of the executive body) is not subject to labour law but the civil (corporate) law. In this case, it means revocation of management powers which is a form of protection of corporate rights of owners and is not a suspension of an employee in the meaning of the Labour Code.

Suspension of an executive body member is possible only for a certain period of time and does not result in termination of labour relations. Dismissal of an executive body member who was suspended from performance of duties shall be carried out pursuant to the labour legislation.

## • Consequences of termination of a labour agreement

On the day of employee's dismissal the employer is obliged to return the duly filled out labour book and to pay the employee off. In case of employee's dismissal he/she receives monetary compensation for all not used days of the annual vacation or the additional vacation for employees with children.

In case the employee did not work on the day of dismissal, such payments shall be made not later than on the next working day after the dismissed employee claimed the payment. In case there was no payment within stated terms due to the fault of the employer and if there is no dispute as to the amount of payments, the employer is obliged to pay the employee his/her average salary for the whole period of such delay up to the day of the settlement.

## • Necessity to agree dismissal with a trade union

In the following cases the labour agreement with the employee may be terminated only upon prior agreement with the trade union member where the employee is a member:

- Change in production and work organization, except for cases of company's liquidation
- Truancy (including absence from work during more than 3 hours within working day without a reasonable excuse
- Wrongful actions of employees working directly with money or merchandise, if such actions cause loss of employer's trust towards an employee
- Determined inconsistency with the position held or work performed due to insufficient qualification or health condition hindering continuance of such work
- Absence from work during more than four months on the row due to temporary disability, except for maternity leave, if the legislation does not provide a longer term for the work place (position) preservation in case of a specific disease
- Immoral actions committed by education personnel inconsistent with work
- Systematic non-performance of duties under labour agreement or internal labour order without reasonable excuse if the employee has already been brought to liability in form of disciplinary penalty or measures of public influence
- Appearance at work under influence of alcohol, drugs or toxins

The legislation may provide for other cases of labour agreement termination upon initiative of the employer without consent of the respective trade union body as well. If the primary trade union organization does not have an elective body, the termination of the labour agreement shall be agreed by a representative of the trade union authorized to represent interests of the trade union members.

The dismissal consent of the trade union is valid only if the employee is dismissed due to reasons stated in the employer's application. If the trade union consented to dismissal due to other reasons, the consent shall be invalid.

## • Liability for Violations of Labour Legislation

Currently a new system of state labour audit is being implemented in Ukraine. State and municipal auditors are vested with additional control mechanisms in order to eliminate i.a. such infringements as shadow employment, violations of minimal wages guarantees and salary payment rules.

Also, since the beginning of 2017 new (increased) fines were introduced for gross violations of labour law. As a result of state or municipal labour audit a penalty in the amount of up to 100 minimal salaries may be imposed upon offenders.

# McCarthy Denning Limited

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United Kingdom

## General information

McCarthy Denning Limited is the original next generation law firm. Established in 2013 with the vision of transforming the way that legal services are provided, we ensure that law firm is designed to support our clients, not expensive infrastructure.

We are a commercial law practice widely respected for our reassuringly straightforward approach. We are focused on building strong client relationships and pride

ourselves on our character and tenacity – it allows us to get off the fence and cut through the jargon to provide confident strategic commercial advice.

We are a progressive and innovative firm with an enviable portfolio of domestic and international clients, many of whom are leaders in their field. We have partnerships with trusted firms around the world to provide quality-driven and commercially sound advice

to our clients. We act for many entrepreneurial, fast-growing companies and we grow with our clients, ensuring our partners are fully equipped to handle a wide range of matters to support clients through their growth.

We recruit the best legal talent and our lawyers are recognised as stand-out individuals.

## Areas of Practice

As a full service law firm, there are very few legal areas in which we do not provide advice.

At McCarthy Denning we have brought together a team of senior lawyers who are recognised as experts in their area of specialisation by both clients and leading legal directories. Unlike many of their peers in the leading traditional firms, however, our lawyers pride themselves on their willingness and ability to go the extra mile. They not only bring commercial expertise to the solving of legal problems, but use their business ideas and networks of contacts to solve commercial problems and create profitable opportunities for our clients.

- Banking and finance
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📍 Albert Buildings,  
49 Queen Victoria Street,  
London, EC4N 4SA.

📍 25 Southampton Buildings,  
London, WC2A 1AL.

☎ +44 (0) 20 7769 6741

June Paddock  
jpaddock@mccarthydenning.com

Marilyn Heward-Mills  
mhewardmills@  
mccarthydenning.com

John Dean  
jdean@mccarthydenning.com

[www.mccarthydenning.com](http://www.mccarthydenning.com)

Collectively, this breadth of experience keeps us at the forefront in our fields, constantly honing our understanding of the way that legal and commercial interests intersect.

## • Framework

UK corporate law is based on both common law and statute. The legislative framework of UK company law experienced a comprehensive overhaul with the implementation of the Companies Act 2006 (the “2006 Act”) which was intended to simplify and modernise company law in the UK.

The 2006 Act exists alongside the Companies Act 1985 and Companies Act 1989 (together with the 2006 Act, the “Companies Acts”). There are a number of other statutes to be considered depending on the activity a company wishes to follow. Although the provisions are similar in the constituent parts of the UK (England and Wales, Scotland and Northern Ireland), there are some differences and what follows applies specifically to England and Wales.

## • Types of Business Structure

The first question to be considered by anyone wishing to establish a business operation in the UK is the type of structure to be used. Although the corporate structure is the one which is most widely used in the UK, there are a variety of other structures available to overseas entities seeking to establish a presence in the UK including setting up a branch or place of business of an overseas company, a partnership, joint venture or a limited liability partnership.

Overseas companies can register as a branch or as a place of business in the UK. A branch is part of an overseas limited company organised to conduct business through local representatives in the UK. A place of business is for companies who cannot register as a branch because they are from within the UK, they are not limited companies or their activities in the UK are not sufficient to define it as a branch (for example if the activity is simply a representative office).



## • Types of Companies

There are different types of corporate structure, which can be used under UK law. The most common structure used is a private company limited by shares. Companies can be either public, which means that they can offer their shares or other securities for public subscription, or private, which means that they are not allowed to offer their shares or other securities to the public. A private company bears the suffix “Limited” or “Ltd” and a public company bears the suffix “PLC”. Other types of corporate structure can be established such as companies limited by guarantee or unlimited companies, but these are not common for trading entities.

Public companies are generally subject to stricter regulations under the Companies Acts and, if they are quoted, they will also be subject to the regulations and codes of practice applicable to the relevant trading market. The formation of a company in the UK is easy and a corporate vehicle structured to the relevant needs can be obtained very quickly with an expedited “same day” service being available. There are no requirements for local shareholders or directors and no minimum capital rules apply (only applicable to a private company). Certain documents, for example the company’s constitutional documents, must be filed with the Registrar of Companies to form a company. A company is required to file its memorandum of association with the Registrar of Companies on applying for registration. The memorandum of association need only state that the initial subscribers wish to form a company under the 2006 Act and they agree to become members of the company and to take at least one share each.

The articles of association contain the regulations relating to the internal management of the company covering matters such as the holding of meetings of directors and shareholders, transfer of shares and changes to share capital, appointment and removal of directors and the powers of directors. There is a standard or model form of articles of association, known as the Model Articles, which many UK private companies follow to some extent. The Model Articles will automatically apply to any company limited by shares that does not adopt its own articles of association on incorporation. No government or other permission is required to establish a company, although there is some regulation of the use of certain business and trading names. Once registered, the name of a company can be changed by special resolution (75% majority) of the shareholders but care must be taken to check that the desired name is available for use by the company. Under the 2006 Act, any person can object to a company’s registered name on the grounds that it is the same as, or similar to, a name in which the objector has goodwill. Objections to the registration of company names must be lodged with the Companies Names Adjudicator.

## • Liability of Shareholders

Every company having a share capital, whether public or private, must have at least one shareholder. There are no rules relating to the residency of shareholders.

In the case of both private and public companies, the liability of the shareholders or members is limited to the amount unpaid on the shares held by them. The company and its shareholders are regarded for company law purposes as separate legal persons.

## • Share Capital

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### **AUTHORISED SHARE CAPITAL**

A company's authorised share capital is the total number of issued and unissued shares in the capital of the company. An increase in a company's authorised share capital requires shareholder approval by ordinary resolution (a simple majority). There is no longer a requirement for a company to have an authorised share capital. If a company wishes to restrict the number of shares it can allot, it will need to amend its articles of association by special resolution (75% majority) to include suitable provisions to the extent the articles do not already contain any such restriction.

## ISSUED SHARE CAPITAL

The shares which are allotted and issued to shareholders will determine the company's issued share capital. In order to allot and issue shares, the company's directors must be authorised, by the articles of association or by shareholder resolution, to issue the relevant shares and also specifically authorised to issue shares where the directors wish to issue shares for cash otherwise than in proportion to existing shareholdings. Directors of private companies incorporated under the 2006 Act with only one class of share will automatically be free to allot shares without the prior authorisation from the members, subject to any express restriction on this power contained in the company's articles. A company incorporated under the Companies Act 1985 will first need to pass an ordinary resolution in order to give the directors the power to allot shares as set out above. These allotments are still subject to any rights of pre-emption in favour of existing shareholders, although, as before, these may be disapplied by the company's articles or by special resolution (75% majority).

Shares must be issued for not less than their nominal value, although shares can be issued as partly paid and the directors can call up the unpaid amount at any time.

## • Minimum Shareholdings

### PRIVATE COMPANIES

There are no minimum requirements for the authorised and issued share capital for private limited companies and the most typical formation is for a company to have an authorised share capital of at least £100 divided into shares of £1. However, it is possible to establish companies with shares of different denominations and in currencies other than sterling.

### PUBLIC COMPANIES

Before a public company can carry on business, it must have a minimum share capital of £50,000 of which 25% of the shares must be paid up.

## • Share Capital Rights

The rights and restrictions attaching to the shares are set out in the company's articles of association. Most companies issue only one class of shares, known as ordinary shares. The rights and restrictions can be changed only by shareholder resolution (75% majority) and, where appropriate, a resolution of the holders of any affected class of shares. Preferred or preference shares would be expected to carry rights (eg to receive dividends, return on capital, etc) ahead of the ordinary shareholders and deferred shares would be expected to carry rights behind those of the ordinary shareholders. In the case of a quoted public company, it would be usual for the shares to be freely transferable and this would be a requirement of the UK markets. However, this is without prejudice to agreements restricting transfer, eg by way of a lock-up or to comply with the requirements of overseas securities laws.

Shares in UK companies are generally held in certificated form, although there is an electronic system known as CREST through which shares in quoted companies are generally traded in uncertificated (non-paper) form. When shares are issued or transferred, details of the shareholder are registered in the company's statutory books and a share certificate issued or a CREST account is credited, as applicable.

## • Shareholder Meetings

Most powers needed to run the company are vested in the directors by the articles of association, although it is possible to include specific provisions in the articles of association or in a shareholders' agreement requiring shareholder approval in relation to certain specified matters. The Companies Acts set out those matters which require shareholder approval. In the case of a private company with few shareholders or which is a wholly-owned subsidiary, shareholder approval can be obtained by written resolution of the shareholders, or otherwise by the shareholders in a general meeting. The written resolution procedure is not available to public companies.

Shareholder meetings require a prior period of notice to shareholders of not less than 14 days save in respect of a private company's annual general meeting where 21 days notice is required. Where not less than 90% of the shareholders of a private company agree, however, these notice requirements can be dispensed with and the meeting (including the annual general meeting) may be held on short notice. A public company can only dispense with the requirement for a notice period in respect of a general meeting if 95% of the shareholders agree and for an annual general meeting, if all the shareholders agree. A general meeting on short notice is not permitted for a public limited company that is trading on a regulated market. Matters reserved to the shareholders by the Companies Acts include authorisations in relation to share capital issues, certain categories of related party transactions, amendments to the company's constitutional documents and the decision to liquidate the company. A private company seeking to reduce its share capital will generally be able to do so using one of two procedures available to it designed to protect the creditors of the company. The first, and perhaps the simplest, procedure is a reduction of capital by means of a special resolution (75% majority) of the shareholders supported by a solvency statement. The second and more onerous procedure in terms of time and cost requires shareholder approval as well as the sanction of the court. Public companies seeking to reduce their share capital are restricted to using the court approved procedure.

A public company must hold a general meeting of its shareholders, known as the annual general meeting, each year at which it is usual to present the accounts, appoint auditors, deal with dividends and elect any directors who have been appointed since the last annual general meeting. Private companies are not required to hold an annual general meeting subject to any express provision to the contrary set out in the articles.

## • Directors and Officers

### APPOINTMENT AND REMOVAL

A company may, if its articles of association permit, have only one director who must be a natural person, and be at least 16 years old.

The rights to appoint directors will be contained in the company's articles of association. Any person proposing to act must indicate his or her consent to act and provide specified information to the Registrar of Companies. It is usual for the shareholders to have the right to appoint directors and for the directors to be able to fill any vacancy on the board subject to the right of the shareholders to confirm the appointment at the next annual general meeting. Similarly, the articles of association would set out the circumstances in which a director can be removed from office and there is also a statutory right, subject to compliance with certain procedures, for shareholders, by simple majority, to remove any director from office regardless of any agreement to the contrary in place with the director.

It should be noted that the office of director is quite separate as a matter of English law from the director's position, (in the case of executive directors), as an employee and accordingly, the removal from office of a director is without prejudice to the director's rights under his or her contract of employment.

### DIRECTORS' DUTIES

Part 10 of the 2006 Act sets out the general duties of directors which are owed to the company. There are seven statutory duties which are based on and replace the previous common law and equitable principles relating to directors' duties. The various statutory requirements and restrictions placed on the powers of directors must be considered in the light of any proposed activity of the company. The effect of these duties is that the directors can be held personally liable if they are deemed to have failed in promoting the success of the company.

It should also be noted that in certain circumstances, directors may become liable to creditors in an insolvent liquidation and that directors will be personally liable for the information about the company contained in any prospectus issued for the purposes of a fund-raising.

Subject to the rules relating to conflicts of interest, as further described below, there is no general legal requirement for a company to have a proportion of independent directors on its board nor is there a requirement for companies to have a supervisory board. However, quoted companies will be expected to comply with best practice in relation to corporate governance, which includes the requirement for independent directors.

Similarly, there are no specific rules on the level of directors' remuneration in private companies and this will usually be a matter for negotiation. In some circumstances, such as payments proposed to be made to a director for loss of office, shareholder approval will be required. In the case of fully listed (quoted) companies, shareholders must approve on an advisory basis, a remuneration report, which sets out, amongst other things, all payments and other benefits made to directors.

### **CONFLICTS OF INTEREST**

Directors have a statutory duty to avoid situations in which their interests can or do conflict, or may possibly conflict, with those of the company. Matters that give rise to an actual or potential conflict may be authorised by the board subject to the board having all necessary powers to authorise such conflicts. For private companies incorporated on or after 1 October 2008, the power to authorise is subject to anything in the company's articles of association invalidating such authorisation. Private companies incorporated prior to 1 October 2008, must pass an ordinary resolution (simple majority) expressly providing the board with the power to authorise conflicts. For a public company, the directors may only authorise a conflict of interest if permitted to do so by the company's articles of association.

### **SECRETARY**

A public company must appoint a company secretary. The company secretary does not need to be a natural person. The company secretary is principally an administrative function and the appointed secretary should be familiar with the filing and other requirements of the Registrar of Companies. Accordingly, it would be usual for the secretary to be based in the UK.

There is no requirement for a private company to have a company secretary. If a private company chooses not to have a secretary, anything which is required or authorised to be done by the secretary can be validly done by a director or any person authorised by a director.

- **Confirmation Statement**

Companies must complete a confirmation statement each year, which gives details of its share capital, shareholders, location of the statutory books, registered office, directors and secretary. It is now also necessary to maintain a register of persons with significant control and influence over the company and to file this information with the Registrar of Companies. Persons with significant control and influence include various categories of person, but broadly speaking are most usually persons who hold more than 25% of the shares or voting rights or have the right to appoint or remove directors but would also include persons who exercise significant control or influence, either directly or through an intermediate organisation.

- **Registered Office**

A company needs to file details of its registered office in England and Wales with the Registrar of Companies and any official notifications will be sent to that address. Subject to certain exceptions, the full name of the company must appear at its registered office and business premises. Any change to the registered office can be made by simple board resolution and must be notified to the Registrar of Companies.

- **Company's Notepaper**

All business stationery must show the company's full name and number and registered office. The names of the directors need not be included, but if the name of any director appears then so must the names of all the other directors.



- **Accounts and Auditors**

Subject to exemptions for small companies, every company must appoint a firm of auditors to audit and report on its accounts for each financial period. Companies are also required to file accounts and a directors' report with the Registrar of Companies, and these documents must comply with the requirements of the 2006 Act and show a true and fair view of the financial position of the company. The 2006 Act lays down detailed rules as to the form and content of accounts and time limits for their delivery to the Registrar of Companies.

- **Other Filings**

Companies must also notify the Registrar of Companies whenever there is a change of share capital, directors and officers and whenever the company creates a charge over any part of its assets. In the case of a charge, the required information must be filed within 21 days of its creation to ensure its security in the event of liquidation. The 2006 Act creates an offence where a person knowingly or recklessly causes to be delivered to the Registrar of Companies a document that is false or misleading and is liable for up to two years imprisonment or a fine.

- **Statutory Books**

Every UK company must maintain a statutory register giving details of its shareholders, persons with significant control or influence, directors, secretary, any issues and transfers of shares as well as charge-holders. There should also be a minute book containing minutes of all meetings of directors and shareholders. A company can now keep its statutory books at an address other than its registered office. This is known as a single alternative inspection location (SAIL), the location must be in the same part of the UK as the company's registered office and notification of the SAIL must be given to the Registrar of Companies.

- **Methods of Raising Finance**

The appropriate method of raising finance will depend on the nature, size and stature of the company. Funds can be raised by way of seed, venture or crowd funding, private equity, a stock exchange listing or loan finance, and within these broad categories there are a variety of options.

# UK | CORPORATE AND PERSONAL TAXES

The following information is based on UK tax law and HM Revenue and Customs (“HMRC”) practice currently in force in the UK. Such law and practice (including, without limitation, rates of tax) is in principle subject to change at any time. The information is correct as at today’s date but may be subject to change following the imminent publication of the clauses of the Finance Bill (No 2) 2017 and the draft consultation clauses for the Finance Act 2018.

The UK’s post-Brexit relationship with the EU has yet to be defined and there are a number of areas of uncertainty. EU-derived law applies or has been implemented in the UK across a wide range of areas, including tax and it is unclear when, how and to what extent UK law in these areas will in future diverge from European rules and regulation.

## **CORPORATE RESIDENCE**

A company is regarded as tax resident in the UK if it is incorporated in the UK or if its central control and management is exercised in the UK. A company incorporated in the UK can also be treated as not resident in the UK under an applicable double tax treaty. It is possible for a company to be dual resident.

## **RATES OF CORPORATION TAX**

Corporation tax is chargeable on a company’s world-wide income and chargeable gains. The rate for the financial year ended 31 March 2018 is: 19% (previously 20%) and will remain at 19% for 2018/19 and 2019/20 after which it will be reduced to 17% for 2020/21.

## NON-RESIDENT COMPANIES

Companies that are not resident in the UK are only subject to UK corporation tax if they carry on a trade in the UK through a permanent establishment. If this applies, the company will be subject to UK corporation tax on all business profits wherever arising which are attributable to that permanent establishment. The profits attributable to the permanent establishment are trading income, income from property held by the establishment and chargeable gains on UK assets used for the purposes of the permanent establishment. Typically, the business profits article of a double tax treaty will limit the corporation tax charge to the profits that are attributable to a permanent establishment in the UK. The profits for corporation tax purposes are then determined as if the establishment were a distinct and separate enterprise, dealing wholly independently with the non-resident company and assuming that it has the same credit rating as the non-resident company, and that its equity and loan capital are reasonable in the context of its independence.

## TRANSFER PRICING

Transfer pricing rules apply to both international and domestic transactions. The basic rule may apply for transactions if an actual provision has been made between any two affected persons and one of them was directly or indirectly participating in the management, control or capital of the other or a third person was participating in the management, control or capital of both the affected persons. The basic rule requires the actual provision to be compared to an arm's length provision (which would have been made between independent enterprises) and, if the actual provision confers a potential UK tax advantage on one or both the affected persons, an adjustment (to bring the profits up to what they would have been if the arm's length provisions had applied) is to be made to the taxable profits of the advantaged persons.

The UK transfer pricing legislation refers to the Organisation for Economic Co-operation and Development's ('OECD's) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('**OECD Guidelines**'). With the continued globalisation of business, transfer pricing has become an issue of increasing importance and was one of the key areas of focus for the OECD initiative to counter Base Erosion and Profit Shifting ('BEPS') practices by multinational corporations.

The OECD Guidelines provide detailed guidance on how the arm's length principle should be applied in relation to related-party transactions, incorporating revisions made as part of BEPS Actions. The OECD Guidelines contain amended and further guidance on applying the arm's length principle, commodity transactions, transaction profit split methods, intangibles, low value-adding intra-group services and cost contribution agreements. The UK legislation has been amended so that it refers to the latest version of the OECD Guidelines.

## CONTROLLED FOREIGN COMPANIES

The Finance Act 2012 enacted a new regime for controlled foreign companies ('CFCs') for accounting periods beginning on or after 1 January 2013. A CFC is a non-UK resident company that is controlled by a UK resident person or persons. A CFC charge will arise if all of the following apply:

- A company resident outside the UK for tax purposes is controlled by a UK resident person or persons
- A chargeable company (i.e. a UK resident company that has a sufficient interest in the CFC)
- The CFC has chargeable profits that pass through 'gateway' tests (that is profits of a specified type that are regarded as sufficiently connected to the UK)
- The CFC is not entitled to the benefit of one or more of the entity-level exemptions. (the exempt period exemption, excluded territories exemption, low profits exemption, low profit margin exemption, tax exemption)

There are three alternative tests to determine control:

- Legal Control (namely the power to ensure the company's affairs are conducted in accordance with the holder's wishes either through holding of shares, possession of voting rights or by virtue of other constitutional documents)
- Economic rights (i.e. entitled to the majority of proceeds on a disposal of a company's shares, or income on a distribution of its income, or the company's assets available for distribution on a winding up)
- Accounting (the 'parent undertaking' or 'parent' control test for the purposes of Financial Reporting Standard (FRS 2) provided that at least 50% of the non-UK resident company's chargeable profits would be apportioned to the UK company parent)

## GROUP TAXATION

For corporation tax purposes, a group relationship exists between two companies if one company holds not less than 75% of the other's ordinary share capital or if both companies are 75% subsidiaries of a third company. In addition, a company which is to be included in a corporation tax group must also be an effective 51% subsidiary of a principal company. For group relief purposes, the requirement for a 75% shareholding relationship is extended so that the company owning the shares must also be beneficially entitled to 75% or more of the profits available for distribution to equity shareholders and of assets available for distribution in a winding-up. It is possible to surrender current year trading losses and other amounts eligible for group relief to a profit making company within the same group. In many cases a payment for group relief is made by the claimant company to the surrendering company as consideration for the surrender. Consortium group relief is also available where a company is owned by a consortium where 75% or more of the ordinary share capital is beneficially owned by several companies between them none of which owns beneficially less than 5% of that capital.

It is possible both for non-UK resident companies to be members of a group for group relief purposes and to trace the ownership of one UK resident company by another through a non-UK resident company. Previously, a non-UK resident

company could not be the surrendering company or the claimant company unless it carried on a trade in the UK through a permanent establishment. However, in 2006 provisions were introduced that in theory allow group relief for a non-UK resident company's losses but such relief is dependant on various tests which in practice are rarely satisfied.

For accounting periods beginning on or after 1 April 2017, the Government intends that the types of corporation tax loss that may be surrendered to another company will be extended, subject to restrictions.

### **TAX DEPRECIATION (CAPITAL ALLOWANCES)**

Tax allowances, called capital allowances, on certain purchases or investments can be claimed. The general rate is 18% per annum calculated on a reducing balance basis. This means a proportion of these costs can be deducted from taxable profits in order to reduce the tax charge. Capital allowances are available on items such as plant and machinery, buildings and fixtures. The amount of the allowance depends on what is being claimed for. In some cases, the rates are different in the year you make the purchase from those in subsequent years. Under the Finance (No. 2) Bill 2017, legislation will be introduced to provide first year allowances for electric vehicle charging points.

### **INTER-COMPANY DOMESTIC DIVIDENDS**

Corporation tax is not normally chargeable on dividends and other distributions of a company resident in the UK, nor are such dividends or distributions taken into account in computing income for corporation tax. This rule also applies to dividends received by the UK permanent establishment of a non-UK resident company.

### **SUBSTANTIAL SHAREHOLDING EXEMPTION**

Capital gains arising from disposals of trading companies in which a trading company has at least a 10% shareholding held for an uninterrupted period of at least one year in the two years preceding the date of disposal are in certain circumstances free of corporation tax on chargeable gains.

## TAX INCENTIVES

Tax incentives are available for investment in unquoted trading companies providing income tax relief and capital gains tax relief.

## CORPORATION TAX ADMINISTRATION

For companies with taxable profits of £1.5m or less, corporation tax is generally payable nine months after the end of the accounting period but large companies (those with taxable profits of over £1.5m) are required to pay in instalments.

Under the Finance (No. 2) Bill 2017, the Government's Making Tax Digital ('MTD') project will replace annual returns with digitised tax compliance, quarterly returns and end of year statements. Digital tax accounts were made available for small businesses from 2016-17. The new rules were due to apply to corporation tax from April 2020, subject to certain exemptions. However, the Government announced on 13 July 2017 that April 2020 is the earliest date that the new rules may apply and that they will not apply until MTD has been shown to work.

## DOUBLE TAX TREATIES

The UK has a large number of double tax treaties a list of which is provided. Relief from double taxation can be by way of treaty, by unilateral relief or by deduction.

- **Other taxes**

**STAMP TAXES**

There are currently three stamp tax regimes in the UK as follows. Stamp duty land tax ("SDLT") is a transfer tax charged on transfers of UK land transactions of whatever nature (subject to exemptions) regardless of the residence of the parties. The old slab system was replaced by the slice system so SDLT for residential property applies to slices of consideration rather than to all the consideration. For transfers of residential freeholds (or leases where the only consideration is a premium) the rate of duty starts at 2% for transactions in excess of £125,000 but not more than £250,000, 5% where the consideration is more than £250,000 but not more than £925,000, 10% where the consideration is more than £925,000 but not more than £1,500,000, rising to 12% for transfers over £1,500,000. Higher rates of SDLT (applying an additional 3% levy) will apply to purchases of additional UK residential properties in England, Wales and Northern Ireland such as second homes and buy to let properties acquired for more than £40,000. A higher rate of 15% may apply to all the consideration where certain non-natural persons (such as a company) purchase an interest in a single residential property for more than £500,000.

Leases are generally chargeable at 1% of the net present value of the rentals under the lease (applying a 3.5% discount rate) where the net present value exceeds £125,000 in the case of residential property and £150,000 in the case of non-residential. Stamp duty reserve tax is a transfer tax charged on agreements to transfer UK shares and securities and on foreign shares and securities which retain a register of shareholders in the UK. The rate of charge is generally ½% of the consideration. Stamp duty is payable on the transfer of UK shares and other marketable securities (where the consideration is over £1000) at the rate of ½% and cancels any stamp duty reserve tax which may be payable. Stamp duty is not chargeable on transfers of most other assets. There is no capital duty in the UK.

## VALUE-ADDED TAX

VAT is a tax paid when goods or services are bought from a VAT-registered business in the EU, including within the UK. VAT is not paid on all goods and services, and sometimes it is paid at a reduced rate. In some circumstances, refunds of VAT paid may be claimed,

Each EU country has its own rates of VAT. In the UK there are three rates.

- Standard rate. The standard rate of VAT on most goods and services in the UK is 20 %
- Reduced rate. In some cases, for certain fuel and power, some energy saving materials, some residential property works etc. VAT is paid at a reduced rate of 5 %
- Zero rate of 0% There are some goods on which VAT is not paid, like most food items, books, newspapers and magazines and children's clothes

The Government's MTD project, to be introduced under the Finance (No. 2) Bill 2017, will apply to VAT from April 2019 for businesses with a turnover in excess of the VAT registration threshold, subject to certain exemptions.

## NATIONAL INSURANCE CONTRIBUTIONS

Employer's national insurance contributions are payable at the rate of 13.8% on earnings in excess of £157 per week. Employees national insurance is payable at the rate of 12% for earnings between £157 and £866 per week and at 2% thereafter. For higher paid employees therefore the highest rate of tax is 47% being 45% income tax and 2% employee's national insurance.



## • Personal taxes

### STAMP TAXES

An individual's liability to tax in the UK is determined by his residence and domicile status. Up until April 2013, the terms "resident", "ordinarily resident" and "domiciled" were not defined in UK legislation so it was necessary to rely on case law and the practice of HMRC. A Statutory Residence Test ("SRT") was introduced with effect from April 2013. The SRT is quite complex and requires a series of tests to be considered. Under the new rules an individual will be treated as tax resident in the UK if he satisfies one of the Automatic UK Tests or the Sufficient Ties Test, and does not satisfy one of the four Automatic Overseas Tests. In addition, the Government has abolished the concept of ordinary residence although it has been replaced by legislation that allows short-term UK resident, foreign domiciled employees to continue to claim the remittance basis where part of their duties is carried out overseas.

Domicile is a fundamentally different concept from residence. Unlike residence, it is not possible to have more than one domicile at any one time and it is not the same as nationality. Essentially, it is the place where an individual has his real home, and has the strongest cultural, economic and family links, and where he ultimately intends to reside. UK domiciled individuals are assessable on their worldwide income and gains.

Domicile can have a significant effect on UK tax liabilities. Resident non-UK domiciled individuals need not pay UK tax on income and capital gains arising overseas if they are not remitted to the UK. The remittance basis results in an individual paying tax on foreign income and capital gains by reference to amounts brought into the UK. Individuals domiciled outside the UK who use the remittance basis will pay an additional £30,000 charge if they have been resident in the UK for at least seven out of the nine preceding tax years, £60,000 if they have been resident in the UK for at least 12 years out of the 14 preceding tax years and £90,000 if they have been resident in the UK for at least 17 years out of the preceding 20 years. They will pay higher rate tax at 40% on remitted foreign dividends

It was intended that various reforms would be included in the Finance Act 2017 and take effect from 6 April 2017. The relevant clauses were included in the Finance Bill 2017 when it was first published on 20 March 2017. However, they were dropped from the Bill following the sudden announcement of the June 2017 general election. Now the Summer Recess is over, the Government is in the process of publishing revised provisions of the Finance (No 2) Bill 2017 so there will be further changes to the remittance rules. Under the Finance (No. 2) Bill 2017, one of the main changes will be the amendment to the deemed domicile rules with effect

on and from 6 April 2017. The legislation provides that those who are not domiciled in the UK will be deemed UK domiciled for tax purposes if they have been UK resident for more than 15 out of the last 20 tax years or if they are born in the UK with a UK domicile of origin. Also the inheritance tax benefit of a non-domiciled individual holding UK residential property through an offshore structure has been removed.

## INDIVIDUAL TAX RATES (FOR THE TAX YEAR 2008/2009)

	Dividends*	Savings others
£1-£33,500	20%**	20%
£33,501-£150,000	40%	40%
Over £150,000	45%	45%

\* New dividend nil rate band on first £5000 of an individual's dividend income (reduced to £2000 from April 2018)

\*\* Personal savings allowance results in nil rate on £5000 of savings income where taxable income other than savings and dividends is below the upper limit of the starting rate band.

Dividends are treated as the top slice of total income, savings as the next slice and other income as the lowest slice.

## INHERITANCE TAX

Inheritance tax is due on an individual's estate on death, on gifts within seven years of death and on certain lifetime gifts. It is charged at the rate of 40% on transfers in excess of £325,000 for the tax year 2017/2018. To the extent that chargeable transfers exceed the nil rate band, the tax rate is 20% for lifetime transfers where the donor survives seven years and 40% for transfers on death and in the three years preceding death. A tapered inheritance tax charge applies to gifts made between three and seven years before death. Inter spouse transfers are free of tax provided either both are domiciled or non-domiciled in the UK for inheritance tax purposes. The rules differ where the transferee spouse is non-domiciled but the transferor spouse is domiciled.

An additional nil rate band of £100,000 (for 2017/18), £125,000 for 2018/19, £150,000 for 2019/20 and £175,000 for 2020/21 is available where a residence is passed to direct descendants. Any unused nil rate band can be passed to a spouse or civil partner.

**CAPITAL GAINS TAX**

Individuals are subject to capital gains tax on their chargeable gains subject to the annual allowance and other exemptions and reliefs. Capital gains tax also applies to other entities that are not companies such as trustees and personal representatives. Gains are taxed for a “year of assessment”. Each year of assessment starts on 6 April and finishes on 5 April in the following year. Under the capital gains tax regime, an individual is taxed on gains arising in a year of assessment during any part of which the individual is resident in the UK. The rate of capital gains tax is 10% for basic rate taxpayers and 20% for higher and additional rate taxpayers and trustees and PRs. However, for disposals of UK residential property the rates are 18% and 28% respectively where principal private residence relief is not available. The annual allowance is £11,300 for 2017/18 (and £5650 for trustees).

- **Double tax treaties**

**TREATY AND NON TREATY WITHHOLDING TAXES (‘WHT’)**

The following chart contains the WHTs that are applicable to interest and royalty payments by UK companies to non-residents under the tax treaties currently in force. Where, in a particular case, a treaty rate is higher than the domestic rate, the latter is applicable. There is no withholding tax on dividends.

Relief at source may be granted on application. Please note that payments of interest and royalties to any UK resident company can be made free of WHT if the recipient is chargeable to tax on the interest or royalty.

<b>Resident recipient</b>	<b>Interest (%)</b>	<b>Royalties (%)</b>
Corporations	0/20	0/20
Individuals	20	20

<b>Non-resident recipient corporations and individuals</b>	<b>Interest (%)</b>	<b>Royalties (%)</b>
Non-treaty territories	20	20
Treaty territories:		
Albania	6	0
Algeria	7	10
Antigua and Barbuda	20	0
Argentina	12	3/5/10/15 (1)
Armenia	5	5
Australia	0/10 (2)	5
Austria	0	0/10 (3)
Azerbaijan	10	5/10 (4)
Bahrain	0	0
Bangladesh	7.5/10 (2)	10
Barbados	0	0
Belarus	0	0
Belgium	0/10 (5)	0
Belize	20	0
Bolivia	15	15
Bosnia-Herzegovina	10	10
Botswana	10	10
British Virgin Islands	20	20
Brunei	20	0
Bulgaria	5	5
Canada	0/10 (7)	0/10 (4)
Cayman Islands	20	20
Channel Islands:		
Guernsey (includes Alderney and Herr)	20	20
Jersey	20	20
Chile	5/15 (2)	5/10 (6)
China (excludes Hong Kong)	10	6/10 (4)
Colombia (not yet in force)	10	10
Croatia	5	5
Cyprus	10	0
Czech Republic	0	0
Denmark	0	0
Egypt	15	15
Estonia	10	0
Ethiopia	5	7.5
Falkland Islands	0	0

<b>Non-resident recipient corporations and individuals</b>	<b>Interest (%)</b>	<b>Royalties (%)</b>
Faroes	0	0
Fiji	10	0/15 (7)
Finland	0	0
France	0	0
Gambia	15	12.5
Georgia	0	0
Germany	0	0
Ghana	12.5	12.5
Greece	0	0
Grenada	20	0
Guyana	15	10
Hong Kong	0	3
Hungary	0	0
Iceland	0	5
India	10/15 (2)	10/15 (6)
Indonesia	10	15
Ireland, Republic of	0	0
Isle of Man	20	20
Israel	15	0
Italy	0/10 (6)	0/8 (7)
Ivory Coast (Côte d'Ivoire)	15	10
Jamaica	12.5	10
Japan	0/10 (10)	0
Jordan	10	10
Kazakhstan	10	10
Kenya	15	15
Kiribati	20	0
South Korea (Republic of Korea)	10	2/10 (8)
Kosovo	0	0
Kuwait	0	10
Latvia	0/10 (2)	0/5/10 (6, 7)
Lesotho <small>(new treaty not yet in force; royalty rate will be 7.5%)</small>	10	10
Libya	0	0
Liechtenstein	0	0
Lithuania	0/10 (2)	0/5/10 (6, 7)
Luxembourg	0	5
Macedonia	10	0
Malawi	0/20 (3)	0/20 (4)

<b>Non-resident recipient corporations and individuals</b>	<b>Interest (%)</b>	<b>Royalties (%)</b>
Malaysia	10	8
Malta	10	10
Mauritius	20	15
Mexico	5/10/15 (7)	10
Moldova	5	5
Mongolia	7/10 (2)	5
Montenegro	10	10
Montserrat	20	0
Morocco	10 (6)	10
Myanmar	20	0
Namibia	20	0
Netherlands	0	0
New Zealand	10	10
Nigeria	12.5	12.5
Norway	0	0
Oman	0	8
Pakistan	15	12.5
Papua New Guinea	10	10
Philippines	10/15 (2)	15/25 (9)
Poland	0/5 (2)	5
Portugal	10	5
Qatar	0	5
Romania	10	10/15 (4)
Russian Federation	0	0
St. Kitts and Nevis (St. Christopher and Nevis)	20	0
Saudi Arabia	0	5/8 (6)
Senegal	10	10
Serbia	10	10
Sierra Leone	20	0
Singapore	0/5 (2)	8
Slovak Republic	0	0
Slovenia	0/5 (2)	5
Solomon Islands	20	0
South Africa	0	0
Spain	0	0
Sri Lanka	10	0/10 (9)
Sudan	15	10
Swaziland	20	0

<b>Non-resident recipient corporations and individuals</b>	<b>Interest (%)</b>	<b>Royalties (%)</b>
Sweden	0	0
Switzerland	0	0
Taiwan	10	10
Tajikistan	10	7
Thailand	25	5/15 (9)
Trinidad and Tobago	10	0/10 (9)
Tunisia	10/12 (2)	15
Turkey (excludes North Cyprus)	0/15 (2)	10
Turkmenistan	10	10
Tuvalu	20	0
Uganda	15	15
Ukraine	0	0
United Arab Emirates	0	0
United States	0	0
Uruguay	10	10
Uzbekistan	5	5
Venezuela	5	7
Vietnam	10	10
Zambia	10	5
Zimbabwe	10	10

## NOTES

UK domestic law generally charges WHT on patent, copyright, and design royalties, although there can be definitional uncertainties. Many treaties allow reduced rates for a wider range of royalties. These are mentioned in this table, even though there may be no UK WHT applied under domestic law.

1. 3% for news; 5% for copyright; 10% industrial; 15% other royalties.

2. Lower rate for loans from banks and financial institutions.

3. Higher rate applies if recipient controls more than 50% of payer.

4. Lower rate applies to copyright royalties.

5. 0% on loans between businesses.

6. Lower rate applies to industrial, commercial royalties.

7. Specific additional conditions apply for lower rate.

8. Lower rate applies for equipment royalties.

9. Lower rate applies to films, TV, and radio.

10. Higher rate applies to certain profit related interest.

## • Framework

Employment law in the UK is based on both common law and statute. Although the employment law regime is not as onerous for employers as in many other European countries, in recent years there has been a significant increase in employment regulation, much of it to implement EU Directives.

## • Employment Contracts

An employer is required to provide an employee with a written statement of specified employment particulars within two months of the start of their employment. This includes details of the disciplinary, dismissal and grievance procedures that apply to his employment. Any changes to the statement must be notified within one month of the date of the change.

## • Cost Of Dismissal And Wrongful Dismissal

There are two issues to consider when dismissing an employee: contractual rights and statutory rights.

- **Contractual Rights:** If an employee's contract of employment is terminated in breach of that contract, the employee may be entitled to claim damages for wrongful dismissal or breach of contract. The amount of damages claimed will be the sum that would put the employee in the position he would have been in had the contract been terminated correctly. Usually, this is the amount of salary and benefits to which the employee would have been entitled during the notice period or until the end of any fixed term contract. This entitlement to damages is subject to the employee's duty to mitigate the losses he suffers by finding alternative employment. Claims for breach of contract may be brought either in the High Court or the County Court or, for claims limited to £25,000 in an employment tribunal.
- **Statutory Rights:** Statute provides for minimum periods of notice. After the employee has been employed for one month, the employee is entitled to receive one week's notice of termination for each complete year of service up to a maximum of 12 weeks' notice for 12 years of employment. The employer is entitled to receive at least one week's notice of termination from the employee, irrespective of the employee's length of service. However, usually the contract provides for a period of notice which can be more generous (but not less generous) than the statutory minimum. It is significant to note that for claims in the Employment Tribunal, each party bears their own costs so costs are not awarded against the unsuccessful party save in exceptional circumstances. This is different from the position in the civil court where costs will usually be awarded against the unsuccessful party.



## • Unfair Dismissal

For employees who have two year's continuous employment with the employer, it is open for such employees to bring a claim for unfair dismissal in the employment tribunal. It should be noted that certain unfair dismissal claims (for example, dismissal for family reasons, including pregnancy, statutory maternity, adoption or parental leave, or dismissals for whistleblowing, for exercising a statutory right or for trade union membership) do not require a qualifying period of employment to be able to bring a claim.

In order to avoid claims for unfair dismissal, an employer should ensure that employees are only dismissed for a "fair" reason, following a "fair" procedure. The five potentially "fair" reasons for dismissing an employee are conduct, capability (ie competence or on health grounds), redundancy, statutory bar or "some other substantial reason" justifying the dismissal of an employee holding the position held by that employee. The procedures to be followed in relation to each category of potentially fair reason for dismissal are slightly different but they all involve consultation with the employee before the dismissal. The Tribunal will also consider whether the employer has acted reasonably in all the circumstances in treating the reason for the dismissal as a sufficient reason for dismissing the employee.

In interpreting whether the employer acted reasonably, the courts and tribunals will look to whether the employer followed a fair procedure when dismissing an employee. In relation to dismissals for conduct and performance, this includes following the ACAS Code of Practice and Disciplinary and Grievance Procedures. Employers must follow fair processes or risk both unfair dismissal and an uplift to compensation, at the discretion of the Employment Tribunal. In determining whether such an uplift should be applied, the Tribunal shall take into consideration the extent to which the employer has complied with the ACAS Code.

If an employee is successful in bringing an unfair dismissal claim, an employment tribunal can order reinstatement, re-engagement or compensation. Compensation is the most common award and comprises the following elements:

- A basic award which is calculated in the same way as a statutory redundancy payment depending on the age and length of service of the employee and a week's pay, which is currently capped at a maximum of £489 per week;
- A compensatory award which will be assessed on the basis of the losses suffered by the employee. The maximum award is currently £80,541 (this figure is usually raised annually in April).

## • **Employment Contracts For Directors**

Employment contracts for directors are commonly referred to as service agreements and should be approved by the board of directors of the company before they are entered into. They usually contain more onerous provisions specifying the director's duties to the company as well as protection for the company's confidential information, "garden leave" provisions, intellectual property rights, and restrictions on activities during employment and possibly post termination restrictive covenants. It is also common for directors to have longer contractual notice periods than other employees. A service agreement usually provides for the director to resign his office of director on termination of the employment. There is no special regime for the employment of directors. However, there are requirements in the Companies Act 2006 which limit the guaranteed term of a director's service contract to less than two years without the prior written consent of the shareholders of the company. There are also special provisions regarding notice and remuneration which apply to directors of UK quoted companies.

## • **Employees' Representatives And Union Representation**

### **COLLECTIVE CONSULTATION WITH EMPLOYEE REPRESENTATIVES**

In a situation where an employer is proposing to dismiss 20 or more employees by reason of redundancy within a 90-day period, or where a transfer of a business (or part thereof) is proposed, employers have a statutory duty to carry out collective consultation and to inform (with specified information) and consult with the affected employees either through a trade union (if that is appropriate) or through their own elected representatives. The penalty for non-compliance with this obligation to inform or consult over collective redundancy is up to 90 days' actual pay for each affected employee if an affected employee or his representative brings a successful claim for a protective award in an employment tribunal. The penalty for failure to comply with the obligation to inform or consult over a TUPE transfer is 13 weeks' actual pay.

## EUROPEAN WORKS COUNCILS

The purpose of a EWC is for employers to inform and consult their workforce on an ongoing basis about measures which are proposed which may affect employment prospects and decisions which are likely to lead to substantial changes in the organisation such as redundancies or transfers of the business. The Transnational Information and Consultation Regulations 1999 (TICE Regulations) apply if central management of a “Community scale” undertaking or group of undertakings is in the UK. There must be at least 1,000 employees within the EU and at least 150 employees in each of two member states.

Information and Consultation obligations are not automatic; if there is no European Works Council (EWC) (either because central management has not initiated one or the employees have not requested one) there is no obligation to inform or consult. However, if a written request has been made by employees (or their representatives) covering 100 or more employees in at least two member states, central management must set up a special negotiating body to negotiate an EWC or a procedure for Information and Consultation. If management refuses to commence negotiations for an EWC agreement within six months of the request or when no EWC agreement has been reached within three years of an EWC request, the default model EWC provisions apply and Information and Consultation obligations arise on matters which concern the undertaking as a whole or at least two undertakings in at least two different EEA states.

## UNION REPRESENTATION

Almost one in four employees in the UK belongs to a trade union. A trade union is an organisation which consists wholly or mainly of workers of one or more description. A trade union’s main aim is to reach agreements with employers over the contractual terms under which workers will work.

An employee who is a member of a trade union has rights which include the following in relation to his employer: to be accompanied to a grievance/disciplinary hearing by a trade union official; not to be refused employment, dismissed or subjected to any detriment by reason of his trade union membership or activities and the right to reasonable paid time off work to take part in trade union activities; where a trade union is recognised for collective bargaining purposes, the employer has a duty to consult on training for workers within the bargaining unit.

## COLLECTIVE BARGAINING AGREEMENTS

A collective agreement is an agreement or arrangement made by or on behalf of a union and an employer which relates to matters such as terms and conditions of work, termination/suspension of employment, disciplinary matters or allocation of work. In large sectors of industry in the UK, levels of pay and other principal terms are agreed in a collective agreement.

Where a union has been formally recognised by an employer for collective bargaining, it can negotiate pay and other terms on behalf of a group (or groups) of workers. This will result in a collective agreement being formed.

The provisions of a collective agreement will be legally enforceable provided the agreement is in writing, and expressly states that the parties intend the agreement to constitute a legally binding agreement between the employer and the union. To be enforceable between the worker and the employer, the collective agreement must be incorporated into the worker's individual terms and conditions of employment. Such provisions will be enforceable between the employer and the worker even if the collective agreement is not legally binding as between the employer and the union.

There are statutory rights in the UK for trade unions to be recognised by employers for collective bargaining purposes, provided various conditions are satisfied. The regime seeks to promote voluntary recognition wherever possible. The recognition procedures are complex and were introduced in the Employment Relations Act 1999. The recognition machinery is contained in The Trade Union and Labour Relations Consolidation Act 1992.

### • Wages And Other Types Of Compensation

The National Minimum Wage Act 1998 specifies a minimum wage for employees over 18. Currently, the rates are as follows: for employees over school age but under 18 the minimum wage is £4.05 per hour, for employees aged 18-20 it is £5.60 per hour and for employees aged 21-24 it is £7.05 per hour, and for employees aged 25 and over, it is £7.50 per hour. These rates are usually revised annually.

The requirement to work overtime and additional payment (if any) for overtime worked is something which is usually dealt with by the employee's contract of employment.

## • Auto-Enrolment Pensions

The obligation to designate a stakeholder pension scheme was abolished with effect from 1 October 2012, although an employer can continue to operate an existing stakeholder scheme for the time being. Transitional protection is, however, available for an employee who was already a member of their employer's stakeholder scheme on 1 October 2012, provided certain conditions are met.

New auto-enrolment duties came into force on 30 June 2012. They are being phased in over a period of five-and-a-half years that started on 1 October 2012 and will eventually apply to all employers in the UK. Once an employer is covered by the new duties, it will be required to auto-enrol its eligible workers – referred to as “jobholders” – in a pension scheme meeting specific standards unless the jobholders are already active members of the employer's qualifying pension scheme. A jobholder can opt out of the pension scheme in which he has been auto-enrolled, but if he does not do so the employer will be obliged to pay minimum pension contributions as long as the worker remains an active member.

Once it is subject to the new duties, the employer must ensure that all its eligible jobholders are enrolled in an automatic enrolment scheme with effect from their automatic enrolment date, unless they are already active members of a qualifying scheme or unless a specific statutory exception applies. A key point to note is that the new employer duties apply to an employer automatically by law once it reaches its staging date. They do not amount to a change to a jobholder's terms of employment requiring any consultation with jobholders. Neither is any consultation necessary under the legislation that requires consultation before changes to pension schemes are made.

## • Insurance Benefits

It is common in the UK for employers to provide their employees with insurance benefits. Probably the most common is private medical insurance. Other benefits which are often provided are life insurance, travel insurance, permanent health insurance and critical illness insurance. Whether or not an employer provides these to employees is a matter for the contract. Where such benefits are provided, the contract should be carefully drafted to ensure that the employer reserves all necessary rights and does not put himself in a position where he is contractually obliged to provide a benefit for which he is not insured.

## • Employment Regulations

The following is a brief summary of some of the main statutory provisions which employers must be aware of when employing employees in the UK:

### ▶ Working Time

*The Working Time Regulations 1998 impose a limit on employee's working time of an average of 48 hours a week averaged over a 17 week reference period. Individual employees can choose to work longer than this by signing an opt-out agreement with their employer. There are also requirements for minimum rest breaks and daily and weekly rest periods. There are special provisions for night work.*

### ▶ Redundancy

*If an employee with two or more years' continuous employment is dismissed by reason of redundancy, he is entitled to receive a statutory redundancy payment from his employer. The amount of the redundancy payment is calculated by reference to the employee's age, length of service and weekly pay (subject to maximum of £489 per week). The maximum statutory redundancy payment (or basic award) is currently £14,670.*

### ▶ Discrimination

*Currently under English law, discrimination on the grounds of sex, race, disability, sexual orientation, age and religion or belief is unlawful. Compensation for workers who successfully bring discrimination claims against their employers is potentially unlimited and can include a claim for injury to feelings.*

### ▶ Protection for Part-Time and Fixed Term Employees

*It is unlawful for an employer to subject to a detriment or treat part-time or fixed term workers less favourably than full time staff unless such treatment can be objectively justified. A worker whose fixed term contract is successively renewed will be considered a permanent employee after four years of continuous employment.*

### ▶ Data Protection

*Employers have a duty to notify their staff as to the personal and sensitive personal data they hold, tell them how it will be processed and obtain their consent to process the data. Such data must be kept securely. Data must be processed in accordance with the provisions of the Data Protection Act 1988 and the various Data Protection Codes issued by the Information Commissioner's Office. Failure to comply carries civil penalties. Workers have the right to request copies of personal data held in relation to them by the employer.*

### ▶ Holiday

*Employees are entitled to 28 days' paid holiday each year (including bank and public holidays) under the Working Time Regulations 1998. There are eight recognised public holidays per year which are included in this minimum entitlement. Employers are free to agree a more generous contractual entitlement and in the UK it is common for employers to allow paid holiday entitlement of between 20 and 30 days and for bank and public holidays to be given in addition to this entitlement.*

► **Sick Pay**

*There is a statutory entitlement to sick pay for up to 28 weeks under the Social Security Contributions and Benefits Act 1992. The current statutory sick pay rate is £89.35 per week but will increase on 6 April 2018. The first three days of any sickness are "waiting days" when no sick pay will be payable. It is open to employers in the UK to agree a more generous contractual sick pay arrangement and it is common practice to do so.*

► **Maternity Rights**

*All pregnant women have the right to paid time off for antenatal care in preparation for the birth of their baby. Pregnant employees are entitled to six months ordinary maternity leave from work and then an additional maternity leave period of six months, regardless of their length of service with their employer. Employees on maternity leave who meet the eligibility requirements are entitled to statutory maternity pay which is pay of up to 90% of the employee's salary for the first six weeks of maternity leave and either £140.98 per week or 90% of normal weekly earnings if lower for the next 33 weeks. A high percentage of this payment is recoverable by the employer out of his National Insurance contributions.*

► **Parental Leave**

*Employees with one year's employment can take up to 18 weeks' unpaid leave for each child up to the child's eighteenth birthday. This right transfers with the employee when he/she changes employer. Statute provides a scheme which allows parental leave to be taken in blocks of one week or more although no more than four weeks in any year. However, employers can agree arrangements that are more generous and in particular which permit leave to be taken in blocks of less than one week.*

► **Paternity Rights**

*Employees with more than 26 weeks' employment may take up to two weeks' paternity leave. Employees who take this leave are entitled to all benefits except pay but they are entitled to statutory paternity pay which is currently £140.98 per week or 90% of normal weekly earnings if lower.*

► **Shared Parental Leave Rights**

*New statutory provisions introduced an entitlement for employees who are parents (whether by birth or adoption), to take shared parental leave (SPL) in the first year of their child's life or in the first year after their child's placement for adoption. The shared parental leave scheme makes up to 50 weeks of SPL and 37 weeks of Shared parental pay available for eligible parents to take or share (that is, everything other than the two week compulsory maternity leave period or an equivalent two-week period in adoption cases). A mother or primary adopter is able to end their maternity or adoption leave, or commit to ending it at a future date, and share the untaken leave with the other parent as SPL. This enables mothers and primary adopters to return to work before the end of their leave without sacrificing the rest of the leave that would otherwise be available to them. SPL can either be taken consecutively or concurrently, as long as the total time taken does not exceed what is jointly available to the couple.*

► **Adoption Rights**

*The adoption regime provides essentially the same leave and pay rights and requires the same qualification provisions as the maternity provisions. Statutory adoption leave (SAL) is available for up to 52 weeks; 39 weeks paid and 13 weeks unpaid. Statutory adoption pay (SAP) is paid at a flat rate which is currently £140.98 per week for the 39-week pay period, or 90% of average weekly earnings if lower. There is no enhanced pay for the first six weeks of SAL. Under the new system of shared parental leave, eligible adoptive parents can share the statutory adoption leave and pay that was available only to the primary adopter. The right for the parent who is not the primary adopter to take two weeks' ordinary paternity leave remains.*

▶ **Parental Leave**

*Employees may take a reasonable amount of unpaid time off to deal with family emergencies.*

▶ **The Right to Request Flexible Working**

*Employees have the right to request flexible working arrangements from their employer. The requirements which must be fulfilled before such a request can be made are that the employee must have been in 26 weeks continuous employment and the employee must not have made another application to work flexibly under the right to request legislation during the preceding twelve months. The employer has an obligation to consider the request and give a reason for any refusal. A refusal to consider a request for flexible working arrangements from a female worker with childcare responsibilities may amount to indirect sex discrimination if it cannot be justified on objective grounds.*

▶ **Time off to Care for Dependents**

*Employees may take a reasonable amount of unpaid time off to deal with family emergencies.*

• **Health And Safety**

An employer is under a common law duty to have regard to the safety of his employees. The employer must provide a safe place of work and safe access thereto, he should take reasonable care that employees are not subjected to unnecessary risks of injury, provide safe systems of work, safe equipment and materials and competent fellow employees. An employer can also be liable at common law for accidents caused by acts of his employees where the employees were acting in the course of their employment. In addition to these common law duties, statutory obligations have been imposed under the Health and Safety at Work Act 1974. The Occupiers' Liability Act 1984 imposes duties on an employer for both his employees and visitors to the premises. Breach of such obligations can result in criminal as well as civil liability.



## • Contracting And Outsourcing Of Work Or Services

The Transfer of Undertakings (Protection of Employment) Regulations 2006 (“TUPE”) which implements the EU Acquired Rights Directive protects employees’ rights in the event of a transfer of a business or part of a business in which they are working. The TUPE regulations do apply to the transfer of employees under outsourcing arrangements but they do not apply to situations where the shares of a company are sold.

TUPE imposes a duty on the vendor of a business to inform and consult with employee representatives before the transfer takes place. There are potentially significant penalties for failure to adhere to these obligations.

The main effect of the TUPE regulations is that in the event of a transfer of a business as a going concern, the employment rights and obligations of the employees of the business or the part of the business being transferred will be automatically transferred to the new owner of the business who will automatically assume those rights and obligations instead of the vendor.

Any pre or post transfer dismissal in connection with the transfer will be automatically unfair unless it is for an economic, technical or organisational reason which entails changes in the workforce. TUPE also makes it very difficult to change the existing terms and conditions of employment of transferring employees.

Unfortunately, it is not open to contracting parties to agree that the TUPE Regulations will not apply. As the obligations which result from a TUPE transfer can be significant, particularly for the purchaser, it is common for business and asset sale agreements in the UK to contain indemnities and other provisions whereby the parties agree the way in which costs and liabilities will be borne.

## • Social Security

The UK operates a pay as you earn (“PAYE”) tax deduction system which must be operated by all employers. There are currently three rates of tax: basic (20%), higher (40%) and additional rate (45%). These percentages are applied to a portion of an employee’s taxable income subdivided into bands. The PAYE system requires the maintenance of pay and tax records for virtually all employees. Tax deducted by the employer under PAYE must be paid to HM Revenue and Customs within specified time limits. Employers are required to use certain forms to record pay and tax information and these must be retained for three complete tax years.

In addition employers must deduct National Insurance contributions. Generally employers must deduct National Insurance contributions on the earnings of the employee – known as employees’ National Insurance contributions. In addition, employers must pay National Insurance contributions at 13.8% of the employee’s earnings as employer’s National Insurance contributions. Again employers have duties to keep records and account to HM Revenue and Customs within specified time limits.

Benefits provided to employees are also taxable and subject to the deduction of National Insurance contributions. Special rules apply for company cars.

## • Types of Ownership

For the purposes of this section, the UK means England, Wales and Northern Ireland but excludes Scotland. Scotland has a different system of land ownership. A few words about terminology may help. Both the words “land” and “property” mean real estate. The word “premises” may also be used. This has the same meaning as “land” and “property” but is most commonly used to describe land or property included in a lease.

There are three types of ownership in the UK. They are freehold, leasehold and commonhold. Freehold is absolute, unlimited ownership. The owner of a freehold has no landlord and can do whatever he likes with his property subject to the general law of the land and subject to any restrictions placed on the property. Freehold ownership is most common for residential houses, large estates and investment property. Leasehold ownership is where land is held by one person (called the tenant) from another person (called the landlord) for a limited period of time on the terms of an agreement (called a lease). Most business premises in the UK are occupied under leases. Residential flats (apartments) are also mostly occupied under leases. A tenant under a lease will pay a rent to the landlord. The lease will last for a limited amount of time. The lease document itself will contain rights and obligations both for the landlord and the tenant and numerous restrictions on what the tenant can and cannot do with the property. Modern commercial leases are long, complex documents which require legal advice. Some leases are extremely long (say 999 years) and these are sometimes referred to as virtual freeholds although that is not strictly a legal term. There are legal reasons why sellers will sometimes prefer to grant extremely long leases or virtual freeholds rather than selling a freehold.

The third form of ownership is commonhold which has been introduced recently. This new system of ownership was designed primarily for blocks of residential flats and other developments with lots of units. At the time of publication, the use of this new system of ownership is very rare.

Properties can be owned in a number of different ways, including by individuals, companies, general partnerships, limited liability partnerships, charities and trusts. Professional advice should always be sought on the most efficient way of owning property in the United Kingdom and the tax implications of any option.

## • Land Registry

There is a computerised register of land in the UK maintained by a government agency called the Land Registry. The register is computerised and accessible via the internet. The register is maintained by a number of district land registries located throughout the country. At the moment, not all land in the country is registered but the vast majority is, especially in urban areas. The government is also committed to introducing a system whereby land can be transferred electronically. At present, that is not possible although the actual process of registration of land is often now carried out electronically.

All registered land has its own “title number” and plan which identifies the land in question. The entries which appear on the register against a particular title number are definitive proof of ownership and most matters affecting the title to properties. There are certain rights and obligations (called overriding interests) which are not noted on the register of title. Overriding interests include matters like rights of way where there might for example be a footpath crossing a property but no express registered right on the title. Many but not all such rights and obligations will be apparent by a proper inspection of the land in question or by making enquiries of the current land owner/occupier.

## • Transfer and Contract

Generally, land can only be transferred by deed. A deed is a document usually prepared by a lawyer which is signed and witnessed and brought into effect in a particular way. This process does not require a notary. In order for a transfer of registered land to be effective, it must be completed by registration at the Land Registry. This cannot be done unless the relevant tax (Stamp Duty Land Tax) has been paid on the documents. This is commented on further below.

It is important to understand in the United Kingdom that verbal agreements in relation to land and even some written agreements are not legally binding. There is usually a period after terms have been agreed during which either party can decide not to proceed if they want. It is usually only when contracts “have been exchanged” that a binding obligation arises and invariably time and costs have to be incurred before that stage is reached.

## • Mortgages And Charges

If money is borrowed to assist with the purchase of land in the UK, the lender will invariably take a mortgage or a charge over the land in question. A commercial mortgage will normally involve two key documents. The first is a loan agreement which can be in the form of a formal agreement or a letter (sometimes called an offer or facility letter). The second document is the mortgage itself which creates the security over the land and is registered at the Land Registry.

The lender who takes a mortgage is called a mortgagee or chargee. The mortgagee's main rights are as follows:

- To be repaid the loan plus interest and costs.
- To prevent a sale of the property if he is not repaid.
- To appoint a receiver to manage and if necessary sell the property.
- If the borrower defaults, to take possession of the mortgaged property and to sell it to repay his loan. It is not always necessary for a mortgagee to obtain a court order before taking possession or selling the mortgaged property.

In practice, the mortgage or charge is now the only recognised formal, fixed security taken over land in the UK. Businesses may also be asked to provide floating charges in favour of institutional lenders. These charge all the assets of the business (by way of a document called a Debenture) but only restrict dealings with those assets if the borrower is in default.

## • Restrictions on Acquisition

There are no restrictions on foreign ownership of UK property but the way in which property ownership is structured is critical and different types of ownership have different implications – including practical, fiscal and regulatory and professional advice should always be obtained. Any new person or body acquiring property in the United Kingdom will have to provide identification evidence and comply with the increasingly complex due diligence requirements imposed by the money laundering regulations.

## • Legal Protection for Buyers and Sellers

In general, the law gives no special protection to buyers or sellers of UK property. Those involved in property transactions will invariably use a solicitor to represent their interests. It is the job of the buyer's solicitor to ensure that the property being bought is free from undisclosed restrictions or obligations and that it is validly transferred at the correct price. The Latin phrase "Caveat Emptor" or "Let the buyer beware" is the fundamental principle: it is the responsibility of the buyer to ensure that it and its professional advisers carry out all appropriate due diligence to ensure that they understand exactly what it is that they are buying and all the implications which ownership of the property will entail before they commit to its purchase.

## • Restrictions on Development

UK law prohibits the development of land without planning permission. Development includes changing the use of land or carrying out building, mining or engineering operations on land. A planning permission is a permission given by the planning department of the relevant local authority. The local authority is allowed eight weeks in which to reach a decision on any planning application. Some types of minor development are permitted without planning permission. Specialist advice needs to be sought on this as what is and is not allowed is tightly controlled.

The law also requires that anybody carrying out building works must comply with building regulations and generally obtain a building regulation consent. That is a formal consent from the District Surveyor (a local government officer) who will consider the plans and specifications of any building works before giving consent and inspect the progress of the works at key times and at their conclusion.

All local authorities prepare plans for how they want different parts of their areas to be used and developed. Those plans are available to the public. They will set out areas or zones where the local authority wishes to encourage particular uses (eg shopping, residential or industrial) and discourage other uses. The local government will consider any application for planning permission in the light of these plans so that, for example, applications for industrial development in residential areas will not succeed.

## • Leases

A lease is the most common way of holding commercial property in the UK. The length of leases will vary depending upon the circumstances and requirements of the parties. There is however a standard which is called an institutional lease. Such a lease is in a form which might be granted by a major financial institution such as an insurance company, investment trust or property company. Institutions tend to look for longer leases, eg: 15 years or more (though terms of 10 years and even 5 years are not uncommon. Sometimes, landlords or tenants are given a right to terminate a lease before it expires. The rent will usually be subject to review most commonly at 5 yearly intervals. Rent reviews in the UK are almost invariably on an upwards only basis. This means that the terms of the lease guarantee to the landlord that either the rent will go up in line with market rents or it will remain the same even if the market rent has fallen below the existing rental level. It is very common for no rent to be payable for a short time at the beginning of a new lease in recognition of the fact that tenants will usually want to fit-out their new premises and not be able to trade from them for a while.

An institutional lease will also be a “clear” lease. This means that the rent the landlord receives will be clear of any deductions to cover the cost of, for example, repairs and maintenance of the building, the supply of services to the building and the cost of insuring the building. All these expenses will be payable by the tenant or (in a building containing a number of tenants), by all the tenants together. These extra payments on top of rent are generally called a “service charge”.

In addition to rent and service charge, there are local taxes to be paid to the local authority which are called business rates. These can be quite significant, particularly in cities. The lease will impose obligations and restrictions on the tenant. The obligation which is most significant from a financial point of view is the obligation to repair, decorate and if necessary re-build or pay towards the cost of rebuilding. In an office block for example the tenant will be responsible for maintaining, repairing and decorating his own property. He will also be responsible through the service charge to contribute towards the cost of repairing and maintaining the building of which his offices form part including all services to the building (eg lifts, air-conditioning and heating plant and systems and so on). It is often the case that these expenses are not capped and if the building and its services are old, the tenant can face very significant extra costs through the service charge. Some of the other important provisions in a typical commercial lease are as follows:

- VAT is often payable on the rent of commercial property.
- Restrictions on alterations to the property
- Restrictions on disposing of the property
- Restrictions on use

Tenants of property used for business purposes will often (but not always) have statutory rights to remain in the property when the lease comes to an end. They will have to negotiate a new lease and pay a commercial rent but the landlord cannot insist that they vacate unless special circumstances apply. It is quite common for the statutory rights to be excluded by agreement between the parties.

## • Stamp Duty Land Tax

Stamp Duty Land Tax (“SDLT”) is a tax payable to the government on land transactions. Any sale of freehold or leasehold land or the grant of a lease at a rent gives rise to SDLT. The tax is payable by the buyer or the tenant. The legislation is frequently changing and advice should always be taken on the amount of tax payable on a transaction. The method of ownership as well as a number of other factors can have a bearing on the amount of tax payable.

## • VAT

Value added tax is generally not payable on residential land. In some circumstances it is payable on the purchase price of commercial land and it is also often payable on rent and charged to tenants. Professional advice should be sought in every instance.



## • Setting Up in Business in the UK

The property choices for a business setting up in the UK include:

### ▶ Serviced Office

*These are usually small offices where office services are supplied as part of the package. The extent of services varies between providers but normally they will include furniture, use of equipment (such as photocopies and fax machines), telephones and telephone answering, conference facilities and secretarial services. The commitment is short term and the cost is relatively high. Such arrangements can however be extremely flexible.*

### ▶ Short Term Licence

*This is similar to a lease but very short term (i.e. 6 months to a year). It would generally give the new business the space only. The tenant would have to supply furniture, equipment and personnel. There would be no security when the licence comes to an end. Sometimes arrangements are granted on a rolling basis, that is they continue indefinitely until brought to an end by notice.*

### ▶ Lease

*The minimum commitment would generally be for between three and five years. Shorter periods are sometimes available from tenants who themselves have surplus space (ie by taking an underlease). Landlords will wish to be satisfied above all that the incoming tenant is able to pay the rent and fulfil the tenant's obligations in the lease. They will want to see accounts and references that demonstrate this. They may also require a guarantor or a rental deposit or some other form of collateral security.*

### ▶ Buy a Freehold

*This would involve a major capital commitment and may be inappropriate for smaller businesses. It does however avoid entering into longstanding obligations with landlords and avoids an ongoing obligation to pay rent and usually means there is more control over when expenditure is incurred, for example to repair buildings.*



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**ILFA E-IURE**

Paseo de la Castellana, 144  
"Feygon I" Building  
28046 Madrid (Spain)

**e-iure.com**

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**Austria:** Kraft & Winternitz  
Rechtsanwälte. **Brazil:** L.O.

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**Bulgaria:** Bazlyankov, Stanoev  
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