Organizational – Legal Forms of Companies

Organizational Forms of Business Entities in Kazakhstan

The legislation in Kazakhstan provides for rather wide range of organizational forms of business entities. Limited liability partnerships (LLP), joint stock companies (JSC), and branches of foreign legal entities, however, remain the most popular. Generally, foreign companies start up their business in Kazakhstan by opening a representative office or a branch, and subsequently transform it to an LLP or JSC. The choice of a business structure is dictated by the legal regime of a particular entity and specific needs of individual businesses. For instance, to conduct certain types of businesses the law requires obtaining a license, which is available only for legal entities, such as LLPs and JSCs. Under the legislation, representative offices and branches do not qualify for a legal entity. At the same time, LLPs and JSCs fall under residency rules of the currency laws, which provide for certain restrictions for residents as compared to non-residents, such as representative offices and branches of foreign entities. Consequently, to make an informed decision, one must carefully balance all pros and cons of a particular type of a business entity, its surrounding legal regime, and specific needs of individual business.

The summary, set out below, provides for general information on the most popular organizational forms of business entities in Kazakhstan: limited liability partnerships, joint stock companies, representative offices and branches of foreign legal entities. As the legislation rapidly changes, it is highly recommended to seek professional advice and assistance in making decision on a particular form of a business entity.

Limited Liability Partnership (LLP)

Similar to practices in other jurisdictions, a limited liability partnership remains one of the most popular forms of a business organization. This is mostly due to limitation of its partners' liability to the amounts contributed to the charter fund. Under the law, LLP is a separate legal entity, and a business organization, capable of having rights and accepting duties, and independently liable on its obligations with its own property.

The law on partnerships as of 22 April 1998 is rather well developed and provides for a detailed legal framework for operation of a partnership. However, it must be noted that partnership's foundation documents constitute its principal basis for operation. With some exceptions, a partnership's foundation documents take precedence over the provisions of the law.

One of the principal foundation documents of an LLP is a charter agreement of its founders. Legally, a partnership begins its existence from the moment of its state registration. However, formation of a partnership starts from conclusion of a foundation agreement by its partners. This document lays down the basis for foundation and operation of an LLP. Provisions of a foundation agreement constitute a commercial secret, and may be revealed to the state or official bodies or third persons only at the discretion of LLP's management, or in cases required by the legislation. A foundation agreement must include a decision on foundation of a partnership, its name and address; a list of names, addresses and bank details of its founders; rights and obligations of the participants (founders); the amount of the partnership charter; contributions of individual partners; their evaluation; provisions on additional contributions; partners' equity in the partnership; the procedure for allocation of net revenue. A foundation agreement may include any other provisions at the discretion of the participants. The terms of a foundation agreement are binding upon the partners, and are enforceable in the court. Under the law, a foundation agreement must be notarized.

It should be noted that a foundation agreement is not obligatory when a single partner founds an LLP. In this situation, a charter is the only foundation document of the partnership. However, when more than one partner founds an LLP, a charter is an obligatory document of a partnership in addition to the foundation agreement. The content of a charter itself does not constitute a commercial secret and may be available to the public. It defines the legal status of a partnership, and must contain its name and address; the list of participants, including their names and addresses; the amount of capital contribution; organization of a management; terms of existence and liquidation. The charter document must also contain the purpose and the scope of a partnership's activities. The general meeting of the partners must approve the charter, and partners must sign it.

Charter Capital

According to the law, the amount of the charter capital should not be less than the equivalent of 100 monthly calculation indexes as of the date of submission of documents for state registration. Currently, a monthly calculation index amounts to 823 Kazakh tenge. Partners can make their capital contributions in money, securities, property rights, and property, including intellectual property. The value of any contribution in non-monetary form shall be appraised and agreed upon by the partners. When the value of a non-monetary contribution exceeds the amount equivalent of 20,000 monthly calculation indexes, evaluation of an independent expert is mandatory.

Founders of a partnership must make their initial contributions to the charter before the state registration of a partnership. The amount of initial contribution should not be less than 25% of the total amount of the charter capital. However, in any event, it should not be less than the minimum set by the law, which is 100 monthly calculation indexes. The rest of the capital must be contributed within one year from the date of its state registration.

Partners must report to the registration authorities on any increase in their charter capital. Any decrease in charter capital is subject to state registration. All decisions on increase or decrease of a charter capital must be adopted by the general meeting of the partners.

Partners' share in partnership's equity is determined in proportion to their capital contribution. A partner is free to sell or pledge its share to any member of the partnership. Approval of other partners is not required. A partner is also free to sell or pledge its share to third persons. However, partnerships' charter documents may provide for certain limitations, which the partnership must follow.

Management

The general meeting of the partners is a principal body of a partnership. Every partner has a vote in the general meeting of the partners equal to its share in the capital of the partnership, unless foundation documents provide otherwise. The charter shall determine the scope of the general meeting's responsibilities. However, the law provides for a list of issues, which constitute exclusive competence of a general meeting. The list includes changes to partnership's charter, including changes concerning the charter capital; establishment of an executive body of the partnership; approval of annual financial statements; adoption of internal rules, regulations and procedures; decisions on participation of the partnership in other businesses; decisions on liquidation and reorganization of the partnership; appointment of liquidation committee and approval of liquidation balance; decision on pledge over of the partnership's property; decision on additional contributions to the charter capital. Foundation documents may provide for additional issues, which will constitute exclusive authority of the general meeting.

In addition to the general meeting, the law provides for establishment of an executive body of the company, which is responsible for management of the operations of a partnership on an ongoing basis. A directorate or a director can constitute the executive body of a partnership. Third persons, non-partners, can be members of an executive body of a partnership. An executive body of a partnership does not require a power of attorney to act on behalf of a partnership. Responsibilities of an executive body include any other issues not reserved after the general meeting by law or by the charter documents of a partnership.

Foundation documents of a partnership may also provide for establishment of an observatory council or any other body, to manage the operations of a partnership.

Liquidation of a Partnership

The law provides for voluntarily and involuntarily liquidation of a partnership. In case of voluntarily liquidation, the decision on liquidation of a partnership is an exclusive authority of a general meeting. A partnership is considered liquidated from the moment of registration of the liquidation with the Department of Justice.

A court decision is required to liquidate a partnership in case of a bankruptcy, invalidity of the registration of a company, conducting activities, subject to licensing, without a license. A partnership

may also terminate if the number of partners exceeds one hundred, in which case the partnership may be reorganized into other form of a legal entity or undergo liquidation. Also, decrease of a charter capital below the minimum level, or failure to make the charter capital in full within one year from the registration date, may be the basis for termination of a partnership.

Pros & Cons of a Limited Liability Partnership

As noted above, the major advantage of this form of a business entity is limited liability of its partners on partnership's obligations. LLP has a status of a separate legal entity, capable of acquiring rights and obligations, and liable on its obligations with its own property. Unlike partners in other types of partnerships, partners are liable only to the extent of their contributions to the charter capital.

Major disadvantages include restrictions imposed by tax and currency legislation. Having a status of a legal entity, a partnership is a resident of Kazakhstan for purposes of tax and currency legislation. The partnership, and not the partners, is liable on Kazakhstan taxes. Residency for the purposes of currency legislation entails stricter regime on import and export of foreign currency and conducting currency operations. Please see sections on tax and currency legislation in Kazakhstan for more detailed information.

Joint Stock Companies

The law on Joint Stock Companies adopted on July 10, 1998 defines the legal status of a joint stock company, rights and responsibilities of its shareholders, and sets procedures for its establishment, reorganization and liquidation. Conceptually it represents a significant step forward from the legal regime established under the old 1994 law on business partnerships.

The Joint Stock Company (JSC) law includes imposition of a general level of responsibility on company officers' and members of the board of directors, and a requirement to act in good faith and in the company's best interests. Where officers or directors have an interest in proposed transactions, a provision limiting self-dealing mandates officers and directors to seek approval of a majority of the disinterested shareholders. Cumulative voting to elect company directors and officers is provided for open JSCs, protecting the rights of minority shareholders.

The law provides for closed and open joint stock companies. A closed JSC may have no more than 100 shareholders who have a preemptive right to acquire shares of other shareholders, and by charter, may also expel shareholders who have violated the company interests. If the number of shareholders exceeds 100, a resolution to reorganize the company to an open joint stock company must be adopted at a shareholders meeting within three months. Closed joint stock companies are not required to register their shares with the National Securities Commission and may independently maintain their own shareholders register.

As opposed to closed JSCs, open JSC may have unlimited number of shareholders. JSC with shareholders of more than 500 are separated into a subcategory of large public JSCs. Other features of this subcategory include trading of the company shares on a recognized securities market, assets at 200,000 times the monthly calculation index, a minimum board of 5 directors, and maintenance of the shareholder register by the Central Depository or an independent registrar. Independent directors must make up for at least half the board of membership of a public JSC. The open public joint stock companies are subject to higher standards and scrutiny. For instance, they must submit their annual audited financial statements to the National Securities Commission, notify the Commission on loss of more than 10% of the assets, loans to the company of more than 25% of issued capital, and transactions or events materially affecting shareholder interests.

The law sets the minimum charter capital at 100 times the monthly calculation index for closed JSCs and 5,000 times the monthly calculation index for open JSCs. Concepts of stated and paid capital are introduced. Companies may have authorized but unissued shares, allowing it to issue new stock by board resolution without having to hold a shareholder meeting, amend the charter or reregister the company.

Closed, private and open share placements are authorized. Closed placement is limited to company founders and other identified persons. Closed placements do not require registration, although

a national identification number must be assigned. If the company is an open JSC, placements after the initial one are open or private. Open placement involves selling stock to anyone by auction or otherwise in accordance with security laws and is subject to registration with the National Securities Commission. Private placement is made to qualified investors who are legal entities with 50,000 monthly calculation indexes in equity capital, operating on the securities market, and not subject to registration.

Currently, Kazakhstan parliament is discussing a draft of the new law on joint stock companies. It is not clear yet what changes it will introduce to the legal regime of JSC and its overall impact on development of JSCs in Kazakhstan.

Representative Offices and Branches of Foreign Legal Entities

The Civil Code of Kazakhstan sets out a legal framework and provides for legal status of representative offices and branches. The Law on Foreign Investments as of 27 December 1994 reiterates provisions of the Civil Code and extends their application to representative offices and branches of foreign legal entities.

According to the law, a branch of a foreign legal entity is a separate subdivision, located and registered in the territory of the Republic of Kazakhstan, and conducting all or part of the operations of the legal entity establishing the branch. A branch does not constitute a separate legal entity and operates on the basis of the Regulations of the Branch. The content of the Regulations of the Branch is similar to the contents of a legal entity's charter. It includes name and location of the branch, as well as name and location of the founding entity, the term and purpose of existence of the branch, and management of the branch. The Regulations of the Branch do not constitute a commercial secret and should be available to the public.

Unlike representative office branches may engage in entrepreneurial activities. This is the major and only difference between the legal regimes of representative offices and branches. The law limits the scope of representative office's activities to representation functions only.

The major advantage of a branch of a foreign legal entity flows from the definition of residents under the currency legislation of Kazakhstan. For purposes of the currency legislation, branches and representative offices of foreign legal entities are non-residents. This implies more liberal regime on conducting foreign currency operations, such as settlement of transactions in foreign currency and free export of foreign currency.

The disadvantage of legal regime of branches and representative offices may arise under the licensing and customs legislation. Under the licensing legislation of Kazakhstan, a number of activities subject to licensing require applicants to have a status of a legal entity. As mentioned above, branches and representative offices do not have a status of a legal entity, and therefore do not qualify for certain types of licenses. As for restrictions under the customs legislation, non-residents of Kazakhstan, such as representative offices and branches of foreign legal entities, require assistance of customs brokers to import goods to the territory of Kazakhstan. Although, services of customs brokers are readily available, in practice this restriction may still prove rather burdensome.

State Registration of Legal Entities

The Rules on State Registration of Legal Entities, approved by the Ministry of Justice of Kazakhstan on April 23, 1999, provide for procedures and details on state registration of legal entities. The Rules provide for state registration of organization, reorganization and liquidation of legal entities, and their representative offices and branches.

An entity is considered organized and starts its existence from the moment of its state registration. Any transaction concluded on behalf of an entity before its state registration may be void, unless a subsequent authorization of such a transaction is acquired.

The state registration of legal entities includes review of their charter documents on compliance with Kazakhstan laws and regulations, issuance of a certificate on state registration, and entry of the entity's registration information into the state register. Subject to registration are all legal entities of the Republic of Kazakhstan, their representative offices and branches, and representative offices and branches of foreign legal entities, regardless of type, activities, and founders.

Generally, the rules on state registration are similar for all types of legal entities. Registration of foundation of a legal entity requires from the applicants submission of a formal application and a charter. The documents shall be submitted to the local departments of the Ministry of Justice at the place of an entity's location. The documents shall be prepared in both Kazakh and Russian, and shall be submitted in two copies. In case of registration of a joint venture with a foreign participation, applicants must also submit for an individual foreign participant - a notarized copy of the passport with Kazakh and Russian translation, and for a foreign company participating in a joint venture – a legalized extract from the trade register or any other legalized official document confirming the legal status of the company in accordance with the laws of the country where the company is founded. A notarized copy of Kazakh and Russian translation should be also provided.

The procedure for registration of representative offices and branches of foreign legal entities is a little bit more complicated and time consuming. In addition to the formal application and provisions of the branch, applicants must also submit a power of attorney for the head of a representative office or a branch; a copy of the decision of an authorized body of a legal entity on opening a branch, a legalized copy of a document confirming legal status of the company in the country of its registration; copies of the founding company's charter documents; and a document confirming location of the branch. A lease agreement or a guarantee letter confirming lease of premises may confirm the latter. All documents shall be accompanied with their notarized translation into Kazakh and Russian.

According to the Rules, the process of state registration shall take 15 days from the date of submission of the application and other required documentation, provided they comply with the requirements of the law. In practice, however, this takes longer.

Issuance of a certificate confirms the act of state registration. However, the process of state registration does not finish here. Within 10 days from the date of issuance of the certificate on state registration, the company must also register with the department of statistics and tax authorities. Generally it takes additional 10 to 20 days to accomplish statistical and tax registration.