



# A LEGAL ROAD MAP

*for Social Impact Bonds in Developing Countries*

NOVEMBER 2014

## ACKNOWLEDGEMENTS

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Instiglio's mission is to improve the impact of social programs in the developing world by tying funding to results. By combining the knowledge and insight of first-rate lawyers from seven different countries, we hope that the Legal Road Map for Social Impact Bonds will contribute to this mission by addressing the legal challenges that impede the successful implementation of results-based financing mechanisms in developing countries.



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# TABLE OF CONTENTS

ACKNOWLEDGEMENTS .....	III
FOREWORD .....	1
INTRODUCTION .....	2
OVERVIEW.....	5
COLOMBIA .....	7
MEXICO .....	24
SOUTH AFRICA .....	39
MAURITIUS.....	68
INDIA .....	82
CHILE .....	108
BRAZIL .....	116

# FOREWORD

From Chile to India, governments are facing a financial crunch, and too often, the budgets that face cutbacks are those that fall into the social services category. To counter this alarming trend innovative social finance programmes are being introduced to support governments fund critical social programmes in partnership with private investors and NGOs.

*A Legal Road Map for Social Impact Bonds in Developing Countries* looks at Social Impact Bonds (SIBs); a financial mechanism that enables investors to pay for a set of interventions to improve a social outcome in collaboration with the government. The SIB model presents a rare opportunity for the private sector to work with governments to fund essential social programmes that address the community's needs. The innovation of the bond is in the repayment – investors are only repaid if and when the social outcomes, such as reducing homelessness or prisoner rehabilitation, are achieved.

TrustLaw, the Thomson Reuters Foundation's global pro bono programme, is proud to launch this report in partnership with Instiglio, the sole social impact bond intermediary located in the developing world, and leading law firm Baker & McKenzie. The report identifies and addresses legal challenges facing the implementation of SIBs in Brazil, Chile, Colombia, India, Mauritius, Mexico and South Africa.

These emerging markets have already shown an interest in exploring the use of SIBs to tackle social issues, however we anticipate this report will garner further support for the introduction of SIBs worldwide. We hope this legal road map will shed much needed light on the feasibility of setting up SIBs to support social change, and show what legal conditions are favourable for their implementation.



**MONIQUE VILLA**

CEO, Thomson Reuters Foundation

# INTRODUCTION

The Legal Road Map is the result of an in-depth study, launched in Instiglio's offices, about the legal challenges that policy innovators face in implementing social impact bonds. Instiglio, a non-profit that designs social impact bonds and similar results-based financing programs in developing countries, came to this idea after brainstorming ways of helping social innovators more easily overcome roadblocks commonly faced by their peers in both developed and developing countries. With invaluable support from the Thomson Reuters Foundation's TrustLaw service, this idea turned into a project that was implemented by five law firms across seven legal jurisdictions from October 2013 and June 2014. This report – dubbed the “Legal Road Map for Social Impact Bonds” – is the culmination of that research.

## WHAT ARE SOCIAL IMPACT BONDS?

A social impact bond is an innovative funding model to incentivize and unlock greater social impact in social programs. This model centers on a simple principle: governments and donors ought to tie their funding to results that matter.

In the SIB model, governments or donors enter into agreements with service providers and investors to pay for delivery of pre-defined social outcomes, such as an improvement in student learning or reduction in homelessness. Investors provide up-front funding to a service provider and the latter work with a defined population to obtain the agreed-upon outcomes. Unlike in regular contracts, in a SIB, governments and donors do not pay if outcomes are not achieved.

Social impact bonds present a number of advantages over current funding models, which have been widely discussed and debated in literature.<sup>1</sup> The most commonly

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<sup>1</sup> To read more about social impact bonds, visit the information clearinghouse [payforsuccess.org](http://payforsuccess.org).

cited advantages are the ability of the model to tie funding to social outcomes, the flexibility that outcomes-based funding provides to social organizations, and the flow of private capital into the social sector. In general, however, the model remains experimental, which is to say that social impact bonds in 2020 may look different than the pilot programs being designed today. With this great promise, a social impact bond also presents great challenges.

Instiglio was created in 2012 exactly for this purpose: To design pilot programs that test key aspects of social impact bonds, learn from these programs, and create a development funding model that, as our mission states, “ties funding to results”, in developing countries.

The underlying mechanics of this funding model introduce new complexity, mostly because they introduce a new type of partnership between investors, governments and service providers and in addition, engage these parties in a new way. For example, as opposed to committing and disbursing funds within yearly budget cycles, governments commit to paying for results, but do not disburse until years later – only if and when results are achieved. Investors accustomed to making bets on business models are for the first time vetting social programs and their ability to generate returns through an unusual third-party commitment. Instiglio’s early partners have encountered a number of legal challenges in designing these programs. Inevitably, reforming traditional practices also disrupts and reinvents the rules of engagement.

## WHY DID WE FOCUS ON LEGAL CHALLENGES FOR SOCIAL IMPACT BONDS?

Until recently there have been no readily available frameworks for anticipating and addressing legal challenges. And as a result, new explorations always ran the risk of failing the legal test, discouraging further explorations and hurting the promise of social impact bonds.

Chief among these legal challenges is an understanding of how to structure the legal relationship among the participating entities. These legal relationships have important consequences. For example, the UK government recently revised the Peterborough recidivism social impact bond with substantial implications for all program participants.<sup>2</sup> Overcoming these challenges consumed a substantial amount of legal resources. Counsel to the intermediary in Massachusetts has reported that 27 contracts were written and more than 1100 legal hours were billed for the Massachusetts recidivism social impact bond.<sup>3</sup> With more than 20 social impact bonds underway around the world and even more in design, tools to overcome these obstacles are now being designed.<sup>4</sup>

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<sup>2</sup> Claudia Cahalane, “Social impact bonds: is the dream over?”, *The Guardian*, May 1, 2014.

<sup>3</sup> Amy Olson, Associate, Ropes & Gray LLP, “The Complex Anatomy of Social Impact Bonds,” SOCAP conference panel, San Francisco, California, September 12, 2014.

<sup>4</sup> *Impact Investment: the Invisible Heart of Markets* [↗](#)



By synthesizing early learning and experience in designing social impact bonds and through informal discussions with dozens of policymakers, investors, and service providers around the world, Instiglio has now captured these early lessons in one document and created an accessible framework to address legal challenges: the legal road-map for Social Impact Bonds.

Instiglio then partnered with five well-regarded law firms, AZB & Partners, Baker and McKenzie, BLC Chambers, Mathos Filhos, and Webber Wentzel, to investigate important legal questions that policy innovators may ask as they consider creating social impact bonds. These questions were answered in a representative set of seven legal jurisdictions: Brazil, Chile, Colombia, India, Mexico, Mauritius, and South Africa. These jurisdictions were chosen because policy innovators in these countries have expressed interest in social impact bonds and because answers from those jurisdictions can be applied to neighboring ones to some extent.

Together these questions do not address every legal challenge that governments, intermediaries, service providers, and investors may face as they design social impact bonds, but they do cover procurement, taxation, government ability to contract across fiscal cycles, and many other topics that provide a road map for the first part of this journey.

## HOW SHOULD THIS REPORT BE USED?

The legal road map has two immediate goals. The first is to methodically document all legal challenges known to date regarding the implementation of SIBs and propose a theoretical framework for addressing such challenges from the perspective of each SIB participant. The second goal is to present the recommendations in the context of various jurisdictions, knowing that a legal framework is of little use if it cannot be relevant to local actors. Thus, the readers have a framework but also examples of how to apply it across a diverse set of jurisdictions.

The audience for this report includes policymakers in government seeking to address policy issues through social impact bonds, service providers and investors considering entering into social impact bond agreements, and intermediaries looking to bring together all these stakeholders into productive partnerships.

This document is not limited to organizations considering social impact bonds. Organizations exploring legal aspects of results-based procurement processes, development impact bonds, and impact investing vehicles may also find its contents useful.

# OVERVIEW

The purpose of this document is to serve as a guide for Instiglio on the main legal issues that it may encounter during the planning and implementation of SIB projects in a particular country.

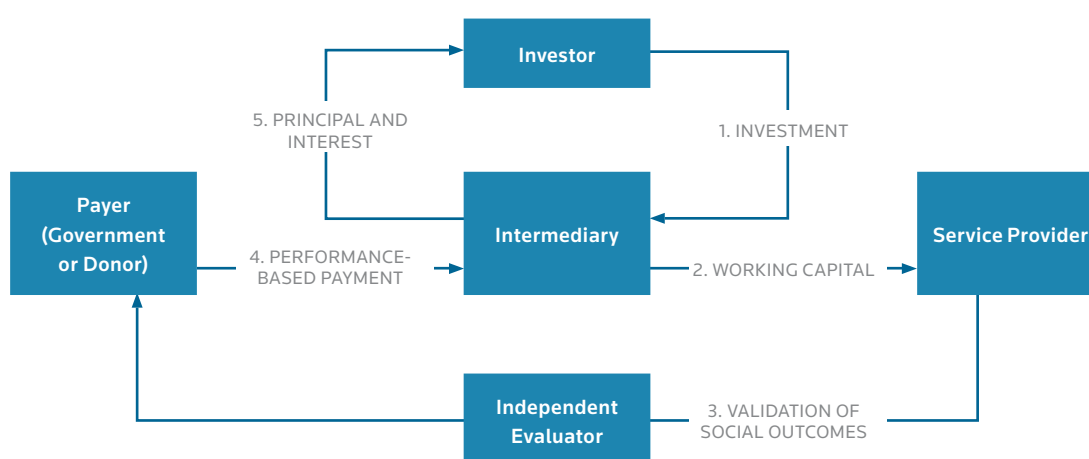
SIBs are an innovative structure that may be used to address social intervention. This implies that bringing them from plans to action unsettles some very-well-engrained paradigms. In Instiglio's experience, legal challenges are a relevant hurdle and often one that discourages exploring SIBs further. With this in mind, Instiglio has created this questionnaire which addresses the legal challenges in the implementation of SIBs. These challenges have been identified using Instiglio's own experience in Colombia. Nevertheless, the questionnaire is not country oriented, but aims to single out general considerations on the law that should be taken into account when thinking of a specific country to bring SIBs to. In this sense, the questionnaire is a guide to carry out a due diligence on potential developing countries where there is interest in SIBs (either from governments, intermediaries or investors).

The questionnaire should ideally help identify whether that country has conditions deemed to be favorable to SIBs from a legal standpoint. In responding to this questionnaire, please consider alternative scenarios and solutions when you encounter a legal or practical limitation, to the extent that such alternatives are reasonable under local law and practice.

## DEFINED TERMS

ABBREVIATION	DEFINITION
INTERMEDIARY	Intermediaries are the local entity, duly set up in the jurisdiction, and responsible for designing and implementing the SIB. The Intermediary is responsible for receiving and managing funds from investors, and for receiving payment from the paying government entity, if the SIB so provides. In this case, the Intermediary will deliver profits to investors.
SERVICE PROVIDER	Service providers are the individuals and legal persons responsible for implementing and carrying out the social programs that will advance the objectives that the government, Intermediary and investors wish to achieve.
SIBs	<p>A Social Impact Bond (<b>SIB</b>) is a specific type of social impact financing in which funds are raised from investors to provide social Service Providers with the working capital with which to deliver their services. For example, a government may enter into a “pay for success” contract with an Intermediary (and its social Service Provider becomes a partner), in which the government only pays if youth employment increases. The Intermediary would raise (from the investors) the working capital that the social Service Providers need to operate the program. If the services successfully improve the youth employment rate, then the government would repay investors for the successful outcomes, together with a previously agreed-upon percentage of profit. If youth employment does not improve, then the government does not pay and investors risk losing their capital.<sup>1</sup></p> <p>This contract will tie payment to the achievement of results. This means that the upfront working capital that is necessary to fund the project is provided by socially oriented Investors. The involvement of Investors and Service Providers is coordinated and designed by an Intermediary. On the other hand, results are assessed by an independent evaluator, an independent third party that audits and verifies the expected outcome. It is this assessment that determines the payment or amount of payment of the government.</p> <p>The chart that follows summarizes the structure of SIBs.</p>

## THE SOCIAL IMPACT BOND MODEL



<sup>1</sup> [What Is a Social Impact Bond?](#)

Instiglio's own [website](#) presents additional definitions of SIBs and discusses the matter in depth. Also, in relation to development, which seems fitting given our target of developing countries, an excellent reference is the report of the Center for Global Development, *Investing in Social Outcomes, Development Impact Bonds*, which was published in October 2013 and which is available [here](#).

## PART 1: INVESTORS

### 1 FUNDING AND PROCUREMENT

- 1.1 Does the law of your jurisdiction allow donors in general (regardless of their legal nature [e.g., straight-out donors or social investors] to fund SIB schemes by directly delivering funds to an Intermediary (either as equity or loans)? Does the law prohibit or limit funding of social service programs? Would the law limit the structure in which the funding is made or the amounts to be funded? What legal formalities would apply to the delivery of funds to an Intermediary (e.g., notarial proceedings)?**

Colombian law allows, in general, funding of SIBs, either through loans or equity contributions into a legal entity. All incoming amounts should be conducted through the Colombian foreign exchange market (i.e., through “foreign exchange Intermediaries” or through duly registered compensation accounts).

- 1.2 Given the legal framework under which the government is allowed to enter into agreements, what options, if any, would an investor have when contracting with the government directly?**

The general rule when entering into agreements is that a public tender process must be carried out. Direct contracting is the exception to that rule.

Nonetheless, under specific situations, it is possible to purchase goods or retain services without using competitive bidding. The grounds for direct contracting, which are contemplated in [PARAGRAPH 4, ARTICLE 2 OF LAW 1150/2012](#), are:

1. Manifest urgency
2. Loans procurement
3. Inter-administrative contracts, provided that the obligations that arise are directly related to the purpose of the implementing entity mentioned in the law or its regulations; exceptions are applicable
4. The procurement of goods and services in the defense sector that requires reserves for acquisition
5. Contracts for the development of scientific and technological activities
6. Trust management contracts entered into by territorial entities when they begin the Debt Restructuring Agreement contemplated in [LAW 550/1999, 617/2000](#) and the rules that modify or add, as long as those are held with financial institutions of the public sector

7. When acquiring assets that are only provided by a single competitor in the market
8. For professional services and management
9. As support, or for the execution of works of art that can only be entrusted to certain individuals
10. Rental or purchase of buildings

Furthermore, there is another way to enter into agreements with the government, which is through public private partnerships (PPAs). It is important to keep in mind that, according to [ARTICLE 3 OF LAW 1508/2012](#), this type of agreement is tied to the development of infrastructure, which could be, in this case, social infrastructure (e.g., schools, hospitals, jails, sports, etc.).

When a PPA project comes from public initiative, a public tender must be undertaken. In the event it comes from private initiative, and money from the government has to be disbursed (as it is the case), a public tender will also have to be undertaken.

Nevertheless, there is one possibility to contract directly, based on [ARTICLE 355](#) of the Colombian Constitution and further regulations. For this, the contractor must be a non-profit organization with a renowned reputation, and the agreement has to be subject to other particular restrictions according to [ARTICLE 3 OF DECREE 777/92](#). An important condition is that no direct consideration in favor of the government may exist, bearing in mind this is a collaboration agreement.

Finally, the agreements with the government are actually negotiable and subject to amendments, but always in accordance to what are stated in the terms of reference and the agreement itself.

### **1.3 Are “hybrid investments” legal or subject to special regulation? Hybrid investments combine equity and debt structures, (i.e., a portion of loaned sums and a portion of direct investment). They could also combine debt and equity; for example, preferred stocks, convertible bonds.**

No special regulations would apply. An SIB could be funded by a combination of debt and equity, in which case, each portion of the funding will be subject to the particular rules applicable to it.

### **1.4 What legal framework applies to debt and equity investments? What limitations or procedures apply to bringing in funds to the jurisdiction?**

Debt and equity investments may be freely made in Colombia. No particular rules apply, other than on conducting funds through the foreign exchange market, as discussed above.

No restrictions on receiving profits (provided profits are actual and have been duly declared) exist.

The parties to a loan agreement are free to agree on the terms of loan repayment. Interest payments are subject to a 14 percent or 33 percent withholding tax rate (depending on whether the term of the loan is less than or more than one year, correspondingly).

**1.5 For equity investments, are there quantitative/qualitative legal limitations on the repatriation of profits (e.g., foreign exchange regulations)?**

No.

**1.6 Would the independent evaluator's report be binding to the government (i.e., assuming that the government is committed to accepting the outcome of the report, could the government challenge such a report)? What are the contract enforcement concerns and mechanisms to ensure that governments follow their commitment to pay according to an independent evaluator's report? Could the government easily challenge the report? What are the risks?**

As mentioned below in this document, according to [ARTICLE 13 OF LAW 80/1993](#), public procurement will be subject to the regulations of civil and commercial law, without prejudice to the particular regulations of the Public Procurement Statute.

Bearing this in mind, according to [ARTICLE 1602 OF THE CIVIL CODE](#), "all agreements are the law of the parties," (i.e., parties will be subject to the provisions stated in the agreement).

Thus, whenever it is agreed that the independent evaluator's report will serve as the mechanism to rate the result and disburse payment by the government, this should bind the parties. There are no exceptional clauses in favour of the government, allowing it to just breach the agreement.

The abovementioned does not preclude the possibility to challenge the report by the government, which has to be done according to the dispute resolution mechanisms agreed upon.

## **2 TAX ASPECTS**

**2.1 What tax rules apply to the funding provided by investors (either donations, loans or equity)? Please consider both loans and equity contributions. Would withholdings apply to the repayment of capital/interest, or dividends/repatriation of equity?**

### **FUNDING THROUGH LOANS**

As a general rule, individuals and companies in Colombia are authorized under the law to freely obtain financing in US dollars (and other currencies) from any entity located abroad.

All financing from abroad must be registered before the Colombian Central Bank (Banco de la República) and all disbursements and repayments of the credit must be channelled

through foreign exchange Intermediaries or, alternatively, through offshore accounts of the Colombian debtor duly registered with the Central Bank as a “compensation account” (cuenta de compensación). The correct registration of the credit grants the right to have access to repayment currency from the “foreign exchange channel.”

In order to duly register financing, it is necessary to comply with the following: (i) Shareholder should request a lender code before the Central Bank by filing a letter to request the assignment of the code and submitting the information required. This process may take between two and four weeks; and (ii) Register the credit before the Central Bank, which requires the filing of the corresponding exchange form and the credit documentation.

#### TAX EFFECTS: WITHHOLDING TAXES

Interest paid abroad will be subject to a 14 percent withholding tax. If the loan is granted for a term of less than a year, the withholding income tax (WHT) increases up to a 33 percent rate.

If the lender is located in a jurisdiction with an enforceable double tax treaty, tax withholdings may be reduced (depending on the type of entity granting the loan and the jurisdiction).

Repayment of capital would not be subject to tax withholdings.

#### DEDUCTIBILITY

Interest paid would be deductible for income tax purposes, provided that: (i) the withholding is duly made and paid to the tax authorities; (ii) the transaction complies with exchange law regulations; (iii) it is related to the income-producing activity of the Colombian entity, as well as necessary and proportionate (both with a commercial criteria); (iv), the transaction complies with transfer pricing regulations (if the lender is a related party); and (v) it complies with thin capitalization rules.

#### THIN CAPITALIZATION

Thin capitalization rules have been enforceable since FY 2013. Accordingly, interest paid on loans (applies only to interest-bearing loans) that exceed a 3:1 ratio when compared with the equity of the taxpayer as of the last day of the previous tax year shall not be deductible for income tax purposes.

#### FUNDING THROUGH EQUITY

Funding can be made by capital contributions to a Colombian entity or through capital contributions with a share premium placement.

#### TAX EFFECTS: REGISTRATION TAX

Registration tax would apply at a rate of 0.7 percent upon an increase of the subscribed capital. The portion of the share premium would be subject to registration tax at a rate of 0.3 percent.

Capital increase is not deemed taxable income for the company. In addition, capital reimbursements would not be subject to income taxes, provided that the repatriated amount does not exceed the investment.

A capitalization with premium is a capitalization where shares are subscribed at a value higher than the par value. In this event, part of the contribution is destined to increase the issued capital of the company, while the remaining portion (which is equal to the difference between the par value and the total value of the shares) will be registered in a special equity account called *prima en colocación de acciones*.

Two additional benefits of a capitalization with premium are, as follow:

1. The current position of Colombian governmental bodies on this matter is that losses can be absorbed using the amount of the premium account.
2. The amounts included in the premium account can also be distributed to the shareholders without the need for them to be capitalized first.

#### TAX WITHHOLDINGS ON THE PAYMENT OF DIVIDENDS

In general terms, dividends paid out of profits that were taxed at the corporate level will not be taxed when distributed to the shareholders; otherwise, any excess will be subject to a 33 percent WHT.

To determine the dividends to be distributed to the shareholders from the profits previously taxed at the corporate level, the Colombian Tax Code provides a formula that consists of adding the net taxable income to the taxable capital gains, and then subtracting the result of adding the income tax and the capital gains tax for the corresponding taxable year and the amount of tax allowances and discounts for taxes paid abroad for dividends from foreign companies.

To the amount obtained from the abovementioned formula, the following must be added:

- Non-taxable dividends from other national or Andean Community companies
- Benefits or special treatments that, by express legal mandate, must be granted to shareholders

The resulting figure will be the maximum portion of dividends to be distributed to the shareholders as non-taxable income (not subject to income tax withholdings for both local and foreign shareholders).

However, the result previously mentioned cannot exceed the company's commercial profit to be considered non-taxable income for shareholders. If the result exceeds the commercial profit, the excess of dividends may be assigned to future commercial profits (carry forward five years) or carried back for two years.

Dividends paid to shareholders located in a jurisdiction with an enforceable tax treaty may be taxed at a lower rate (this should be analysed on a case-by-case basis).



## 2.2 Does the Jurisdiction have international investment agreements, preferential trade or double taxation treaties in force? Are there any on the way of becoming effective (e.g., being negotiated, pending ratification, etc.)?

Currently, Colombia has enforceable tax treaties with Spain, Switzerland, Chile, Canada, Mexico and the Andean Community of Nations (Ecuador, Bolivia and Peru).

Treaties have also been signed with Portugal, Korea, India and Czechoslovakia, but these are still pending internal approval proceedings before becoming enforceable.

## 2.3 Are there tax incentives/breaks for socially oriented investing? How cumbersome is the process for obtaining/collecting these incentives?

Some benefits may apply to specific investments (i.e., for a region or a specific group of individuals); however, it would be necessary to know the destination of the investments.

In general terms, pursuant to [ARTICLE 125 OF THE COLOMBIAN TAX CODE](#), income taxpayers may deduct, for income tax purposes, the amount of donations made to non-profit associations, corporations and foundations, whose corporate purpose and activity correspond to the development of health, education, culture, religion, sports, scientific and technological research, ecology and environmental protection, defense, protection and promotion of human rights and access to justice or to social development programs, provided always that the same are of general interest.

In this case, the deduction cannot exceed 30 percent of the taxpayer's net taxable income, calculated before subtracting the donations (some exceptions are applicable).

In order to apply for the benefit, it would be necessary to fulfil some legal requirements (i.e., recognition of legal personality and certificate issued by the statutory auditor).

On the other hand, depending on the corporate purpose of the non-profit entity, there would be additional benefits:

- Donations to sports and recreational or cultural agencies that are non-profit corporate bodies may allow a deduction equivalent to 125 percent of the amount of the donations.
- Donations to non-profit entities for technological scientific projects or of technological innovation may allow a deduction equivalent to 175 percent of the amount invested. The deduction cannot exceed 40 percent of the taxpayer's net taxable income, determined before subtracting the corresponding investments.

## 2.4 Is it possible to write off losses or to reframe a failed investment in SIBs as a grant/donation? If so, would the grant/donation be subject to taxes?

Tax losses (originating from expenses that comply with the deductibility test) may be offset with taxable income without limitations.

Donations would be deductible as long as they comply with the conditions detailed under [Section 2.3](#).

## PART 2: GOVERNMENT

### **1 What is the general structure of the state in your jurisdiction? What degree of autonomy do government entities have for contracting?**

Colombia is a republic and the Colombian state operates on the principle of “political centralization, administrative decentralization.” Government entities have substantial autonomy for procurement within the framework of the law.

### **2 Do applicable public procurement rules authorize the implementation of an SIB scheme, i.e., funding social programs by means of an agreement between a government agency and an Intermediary, in which payment from the government would be entirely contingent on the organization achieving measurable and positive social outcomes?**

Public procurement rules authorize the implementation of an SIB scheme. [ARTICLE 13 OF LAW 80/1993](#) states that public procurement agreements are subject to commercial and civil law (without prejudice of the special rules of the Public Procurement Statute) while [DECREE 777/1992](#) states that the agreements with non-profit organizations shall be subject to the requirements and formalities required by law for contracting between private persons.

There are no further limitation for contracting schemes other than those in the regime of incapacities, conflicts of interests and incompatibilities, and the principles of public functions and fiscal management.

### **3 How does the government of the jurisdiction contract social services? Is public procurement subject to special rules or would it be subject to general and commercial law rules? Is there flexibility in the performance and supervision of contracts by government?**

In case of contracting with non-profit organizations, agreements are ruled by [DECREE 777/1992](#) and the government is authorized to contract directly with this type of organizations whenever the conditions of Decree 777 are met (having to be executed in writing and have purposes of promoting programs of public interest). In other cases, the contracting of social services will be subject to the general provisions of the Public Procurement Statute that apply the public tender procedure as general rule.

Decree 777 states that, before contracting with the Intermediary, the government must issue a certificate of availability that guarantees that the government has the money in case the government pays the Intermediary. Also, the performance of the contract should be under the surveillance of a controller and the Intermediary needs to purchase the guarantees required by the government in each particular case. Finally, during the performance of the contract, the Intermediary is subject to the regime of incapacities,

conflicts of interests and incompatibilities, and the principles of public functions and fiscal management.

Similar rules apply whenever contracting in accordance with the Public Procurement Statute.

**4 May an Intermediary tender for both design and implementation stages or would there be impediments because of conflict of interests? Would it be possible to combine direct contracting or PPPs with public procurement and, thus, avoid the conflict of interests issue (i.e., Intermediary would either design or implement under a PPP or direct contract and, thus, be able to tender for the remaining stage.)?**

There are no restrictions in Colombia to tender for the design and implementations of a particular project. One agreement may have multiple purposes. This is recognized by Colombian public procurement regulations ([ARTICLE 1, DECREE 3629/2004](#)).

There will be no conflict of interest even if the design and implementation are tendered separately. Conflict of interest is not particularly regulated in the Public Procurement Statute. There is a just general prohibition to act in conflict of interest for public officers, particularly when they are acting as controllers.

According to [ARTICLE 40 OF LAW 734](#), a direct and particular interest from the public officer or controller has to be present to constitute an occurrence of conflict of interest. This seems unlikely in cases when one same person tender in equal conditions for two different contracts even if they are related.

**5 Does annual budgeting apply? If so, are there legal mechanisms to ensure future payments? Can these mechanisms commit future administrations? Where the law does not readily allow for future payments, could trust structures or special vehicles be set up to make up for any shortfalls in the law?**

Yes, annual budgeting applies from 1 January to 31 December. As mentioned before, the government must issue a certificate of availability and make a budget registration before making the agreement enforceable.

The legal mechanism to ensure the payment is through “future payments” (*vigencias futuras*), a figure for assuming obligations that will affect future fiscal years of that when the obligation was acquired. Future payments need to be authorized by the relevant authority.

There exist ordinary and extraordinary future payments.

- **ORDINARY:** This is not subject to particular matters, but the execution of the money must begin on the fiscal year when they were approved. This mechanism may not work for Instiglio when considering that under the proposed SIBs, payment from the government will depend on the occurrence of a condition.
- **EXTRAORDINARY:** This is subject to particular matters (infrastructure, energy, communications, aeronautics, defence, security and guarantees within concession agreements), but there are no requirements that the execution of the money begins on the fiscal year when they were approved.

Finally, it is possible to create a trust structure, but authorization for binding future payments has to be also obtained, so the functioning will be the same.

**6 What happens if a government entity does not execute the whole of its annual budget? Would there be any negative consequences for the entity? If so, would there be legal mechanisms to enable the “freezing” of budget funds?**

Whenever the annual budget is not totally executed, the entity will have to implement “budget reserves” that permits the use of the remaining budget in the following fiscal year. The agreement serving as the ground of the reserve has to be valid and enforceable. Also, the budget reserves are possible only under extraordinary circumstances that prevented to execute the money on the fiscal year they were approved. The reserves are not freely executable.

## PART 3: INTERMEDIARY

**1 If the Intermediary carries out activities as simply an advisor, would the law require the Intermediary to set up a permanent presence in the jurisdiction? If the Intermediary is receiving and administering investors’ money, would the law require the Intermediary to set up a specific type of entity in the jurisdiction?**

Depending on the characteristics of the activity, the Intermediary may need to set up a branch or a subsidiary in Colombia.

[ARTICLE 471 ET SEQ. OF THE COLOMBIAN CODE OF COMMERCE](#) set forth the notion of “permanent activity” and requires foreign companies carrying out “permanent activities” in Colombia to establish a Colombian branch (or that a subsidiary carries out the activities). The Code of Commerce does not define the term “permanent activity.” However, such code considers that, for the purposes of [ARTICLE 474](#) of the Code of Commerce, such activity includes, among others, opening commercial establishments or offices in Colombia for business.

As there is no exhaustive list of what is a “permanent activity,” Superintendencia de Sociedades (i.e., the Colombia regulator and enforcement authority for commercial companies) has issued doctrine to interpret Article 474. Among other criteria, it has stated that any activity, whether it is listed or not in Article 474, can be considered “permanent” depending on the circumstances of each particular case. The word “permanent” requires that the activity should have elements of stability, constancy, duration or perseverance and require an infrastructure to support such activity. An activity which does not have these characteristics, such as the occasional purchase of goods or the occasional rendering of services, would not be considered permanent.

## 2 What types of entities are available in the jurisdiction?

Please refer to **Annex 1**.

## 3 Assuming that the Intermediary will receive funding (either through equity or loans) and will use them for the advancement of social projects, could the law of the jurisdiction consider that the Intermediary is carrying out financial intermediation activities or any other sort of regulated activity? What thresholds apply (if any) for being considered a regulated entity (i.e., under financial regulations)?

No, provided that the Intermediary uses the funds it received for the implementation of the SIBs (i.e., that the Intermediary does not simply keep the funds and commits to simply managing the funds in return for a profit).

## 4 Does the law of the jurisdiction set forth foreign exchange constraints or mechanisms for remitting money into the jurisdiction and converting it into local currency?

Yes. Please refer to our discussion above.

## 5 If the Intermediary requires bringing foreign personnel into the jurisdiction, please discuss briefly what types of visas/permits may be required.

Please refer to the next question.

## 6 Assuming that the Intermediary has been already set up as an entity in the jurisdiction, please discuss briefly what types of visas/permits would be required for it to engage overseas personnel for work in the jurisdiction.

Foreigners that enter the country with working or business purposes require the respective visa or legal permit that allows them to perform activities related to such purposes.

Colombian immigration regulations provide for a number of visas and permits. For engaging personnel to work or collaborate with business in Colombia, we believe the following options of visas and permits may be requested depending on the circumstances:

1. **TP-4 VISA** – The TP-4 Visa is a multiple-entry visa issued for a maximum of three years. It expires automatically if the foreigner is not in the country for more than 180 consecutive days. This visa is used primarily by management, technical and administrative personnel (of private or public commercial entities) who are hired through employment agreements or independent service agreements by a local entity in Colombia in order to assume specific positions in Colombian branches or subsidiaries. The

spouse and children of the person obtaining a TP-4 Visa may obtain a Temporary Beneficiary Visa.

2. **THE NE VISA** – An NE Visa can be granted for up to five years depending on the type of NE Visa granted (i.e., NE-1, NE-2, NE-3 and NE-4, depending on the level of the person within the organization, the activities to be performed and the liaison with a multinational company), with multiple entries of up to one year each. It expires automatically if the foreigner exceeds the term granted to stay in the country. It is issued to foreigners who can show they are business persons who are entering Colombia to conduct business, attend meetings or carry out marketing studies. Persons entering Colombia under an NE Visa cannot settle in Colombia. The activities carried out in Colombia must not generate payment of a salary or fees in Colombia except for the case of NE-2 Visas.
3. **PIP-6 PERMIT** – A PIP-6 permit is issued for foreigners that come from non-restricted nations that intend to participate (with no labor relation) in academic, scientific, artistic, cultural or sports events, as well as for presenting work interviews for recruitment processes, business, trainings, commercial and business contacts and managements and journalistic coverage. The validity period of such permit is up to ninety (90) days.
4. **TP - 12 VISA** – The TP - 12 Visa is issued for foreigners that come from restricted nations that intend to participate (with no labor relation) in academic, scientific, artistic, cultural or sports events, as well as for presenting work interviews for recruitment processes, business, trainings, commercial and business contacts and managements and journalistic coverage. The period of this visa is of ninety (90) days with multiple entries.

We also believe necessary to mention the existence of Visa TP-6 which is granted to foreigners that wish to enter the country as volunteers or collaborators of a non profitable organization. In such cases, the period of this kind of visa is of one (1) year

## **7 Is there any requirement for Intermediary's directors/officers in the Jurisdiction to be national or residents of the Jurisdiction?**

From a labor perspective, there is no restriction for a foreigner to be a director of an Intermediary company. Instiglio may not establish as a requisite to enter the company to be a foreigner, as such behaviour would constitute discrimination, but it may design foreigners as managers and directors.

Note that irrespective of the nationality, local labor laws would always apply for services rendered in Colombia.

## PART 4: SERVICES PROVIDERS

### **1 Assuming that the Intermediary signs a contract with the government, would the law allow the Intermediary to freely choose and contract with the service provider? Would the contract with the government restrict the choice of service provider made by the Intermediary?**

We understand that the Intermediary's role is essentially to subcontract with the service providers the performance of parts or the entirety of the agreement. The selection of subcontractors is, in general, under the discretion of the contractor in response to the autonomy principle for developing its production organization and performance of the agreement. Nonetheless, in practice, governmental contracts generally require that the subcontractors be preapproved by the governmental entity.

### **2 Is there a substantial risk that services providers' personnel could be re-characterized as employees of the Intermediary? What mechanisms are available for reducing/managing this risk?**

Yes, there exists a risk. Independent contractor must always act on an independent and autonomous manner without any subordination being exercised over them.

Colombia applies the principle of the primacy of reality over forms. Therefore, the independent nature of a Service Provider, at the end, will depend on how the Service Provider truly performs his activities on the day-to-day basis and not by the kind of written agreement the parties execute.

Additionally, our laws assure the existence of an employment agreement in every personal remunerated service (presumption of the existence of a labor agreement). According to this presumption, a Service Provider will just need to prove that he rendered a personal service and that he received remuneration and the entity would have the burden of proving that the provider was an independent contractor with no subordination.

Circumstantial evidence generally determines whether subordination is present or not in a relationship. Our labor courts have concluded the existence of subordination based on specific situations, such as:

- Whether the person goes every day to the same place under a certain schedule
- Whether the person has an office that is paid by the contractor of the services
- Whether the person obtains reimbursement for some expenses (i.e., employees' phone bills, transportation) and receives the payment of typical labor payments (These costs should be deemed as operation costs.)
- Whether the person gives direct orders to other employees of the contractor
- Whether this person renders certain reports to the person or company to whom the person is subordinated

- In general, subordination is any situation that may be interpreted as with absence of independence and autonomy.

The declaration of the existence of an employment agreement depends on a labor judge. Therefore, it is needed for the Service Provider to present a judicial claim and for the judge to consider that the relation between the parties is labor nature.

If such nature is effectively proven, the entity will be forced to pay for the time the activities were performed, in addition to the compensations already paid, fringe benefits, vacations, severance for unilateral termination (if such were the case) provided by law to employees, plus a late payment indemnity equivalent to one day of salary for each day of delay in the payment of the social benefits, counted from the date of termination of the contract up to the date in which the complete payment takes place, as long as the judge declares that the entity acted in bad faith. This late payment indemnity has a 24- month limitation. If payment takes place after month 24, then moratorium interests defined by government authorities would start accruing.

In addition, the entity could be forced to pay another indemnity as failure to deposit the accrued unemployment aid amount (one of the mandatory social benefits equivalent to the payment of one month of salary for each calendar year of services) in a special unemployment fund entity, as ordered by the law. The indemnity is equal to the payment of one day of salary for each day of delay in the deposit of the accrued unemployment aid counted from 15 February of each calendar year up to the date of termination of employment or until the date of the deposit, whatever occurs first.

Finally, unless the Service Provider has made timely and complete payment of social security contributions to social security during the course of the independent service, Instiglio would be condemned to pay the health expenses duly proved by the contractor as well as the pension quotations since the date of initiation of the activities plus the default interests.

In addition to having an independent services provision agreement with special labor indemnity clauses, Instiglio should consider the following recommendations for the day-to-day practical management of its relations with its Service Providers so as to minimize labor and employment-related risks:

- Hire services that can be developed on an independent manner.
- Avoid granting typical labor benefits.
- Avoid written communications, giving orders (such as internal memos and electronic mail messages) and ambiguous situations that could lead to a construction of employment agreement, such as including the Service Provider in letters addressed to employees.
- Avoid delivering presentation cards, carnets, corporate email and signature in the corporate email or uniforms of the Instiglio. Also, try to keep the Service Provider from participating in activities intended for the employees of Instiglio.
- Demand as a contractual obligation of the individual to be independently affiliated



to the social security system in health, pensions and occupational risks and ask for the proof of payment of the monthly quotations based on the total amount paid as fees. The Service Provider should perform contributions to the social security system based on the 40 percent of the monthly amount of the contract, with a cap of 25 percent of the minimum monthly statutory salaries. These obligations should be verified by Instiglio.

- Avoid providing certifications of the existence of an employment agreement with the company. (This is personal favors usually done to procure loans.)
- Verify that the Service Provider assumes the costs of his activity and operation with his own tools and work materials, thus, avoiding to provide work materials and tools to perform the contracted services, as the owner of such means shall be the services provider. Any expenses that are recognized by Instiglio to the Service Provider should be deemed as operation costs and not as mere reimbursements.
- It is desirable that in the execution of these contracts, the fulfillment of objectives and agreed obligations are verified so as to avoid instructions and orders about aspects of the agreement, that any noncompliance of obligations is managed as a breach of the agreement and by no means deliver reprimands in writing, as this is a typical action of an employer.
- In general, avoid all kinds of actions that may be considered as involving subordination.
- Formalize the termination of the agreement, by mutual consent through the execution of a settlement agreement before competent labor authorities in Colombia, to clarify the nature of the relation between the parties and the independence of the Service Provider in the provision of services.

## ANNEX 1

# TYPES OF ENTITIES AVAILABLE IN COLOMBIA

	SIMPLIFIED SHARE COMPANY: "SOCIEDAD POR ACCIONES SIMPLIFICADA", SAS	CORPORATION: "SOCIEDAD ANÓNIMA", S.A.	LIMITED LIABILITY COMPANY: "SOCIEDAD DE RESPONSABILIDAD LIMITADA"	BRANCH: "SUCURSAL"
LEGAL ENTITY	Subsidiaries are taxed on worldwide income at 25 percent income tax rate for FY 2014.  There is an additional income tax called CREE calculated at 9 percent rate for 2014 which is intended to fund certain employee contributions.	Subsidiaries are taxed on worldwide income at 25 percent income tax rate for FY 2014.  There is an additional income tax called CREE calculated at 9 percent rate for 2014 which is intended to fund certain employee contributions.	Subsidiaries are taxed on worldwide income at 25 percent income tax rate for FY 2014.  There is an additional income tax called CREE calculated at 9 percent rate for 2014 which is intended to fund certain employee contributions.	Branches are taxed only on Colombian source income at 25 percent income tax rate for FY 2014.  There is an additional income tax called CREE calculated at 9 percent rate for 2014 which is intended to fund certain employee contributions.
DURATION	Can be unlimited	Term required	Term required	Term required – not exceeding that of home office.
CORPORATE PURPOSE	Can be any licit commercial activity	Specific activities are required	Specific activities are required	Specific activities are required
FORMALITIES	No public deed required (unless real estate is contributed)	Public deeds required, unless qualified as small companies	Public deeds required unless qualify as small companies	Public deeds always required
LIABILITY OF OWNERS OR SHAREHOLDERS	General rule: liable up to the amount of capital contribution  No residual liability for tax or employment matters	General rule: liable up to the amount of capital contribution  No residual liability for tax or employment matters	General rule: liable up to amount of capital contribution  Residual liability for employment and tax obligations of the company.	Home office is liable for all assets, liabilities and obligations of the Colombian branch.  A special purpose vehicle can be set up abroad as the home office of the Colombia branch to contain the liability.
NUMBER OF OWNERS	One or more individuals or companies	Minimum of five (5). None of which can hold 95 percent or more of the shares.	Minimum of 2, maximum of 25. No limitation on percent of capital held.	100 percent owned by the home office.
STRUCTURE	<ul style="list-style-type: none"> <li>— Shareholders assembly</li> <li>— Legal representative (one or more)</li> <li>— No board of directors required</li> <li>— Statutory auditor is optional until the company reaches income or assets thresholds</li> </ul> <p>This is the simplest management structure. Shareholder(s) can be represented in Colombia and can adopt and implement decisions quickly, with a good level of control where their prior consent is required for certain acts of the legal representative.</p>	<ul style="list-style-type: none"> <li>— Shareholders assembly</li> <li>— Legal representative (at least one principal and one alternate)</li> <li>— Board of directors (minimum three [3] principals and three [3] alternates)</li> <li>— Statutory auditor required</li> </ul> <p>Shareholders can delegate powers but board directors cannot. All board decisions need personal participation of directors, which can be difficult if directors are not local.</p> <p>Very effective with a local board and management</p>	<ul style="list-style-type: none"> <li>— Board of Partners</li> <li>— Legal Representative(at least one principal and one alternate)</li> <li>— No board of directors required</li> <li>— Statutory auditor is optional until the company reaches income or assets thresholds</li> </ul> <p>The simplest management structure. Partners can be represented in Colombia and can adopt and implement decisions quickly, with a good level Of control where their prior consent is required for certain acts of the legal representative</p>	<ul style="list-style-type: none"> <li>— Legal Representative (normally with wide powers) (at least one principal and one alternate)</li> <li>— Statutory auditor required</li> <li>— No shareholders or board of directors in Colombia</li> </ul> <p>The home office abroad must make decisions on appointments or Authorizations that require legalized board minutes are to be sent from abroad. Thus, implementation can be slow, but a good level of control can be achieved by the home office.</p>

	SIMPLIFIED SHARE COMPANY: "SOCIEDAD POR ACCIONES SIMPLIFICADA", SAS	CORPORATION: "SOCIEDAD ANÓNIMA", S.A.	LIMITED LIABILITY COMPANY: "SOCIEDAD DE RESPONSABILIDAD LIMITADA"	BRANCH: "SUCURSAL"
CAPITAL AND FUNDING	<ul style="list-style-type: none"> <li>— No minimum capital</li> <li>— On capitalization, a bylaw amendment is required only if there are insufficient shares in reserve.</li> <li>— Maximum term to pay the subscribed capital is two (2) years. There are no other conditions.</li> <li>— There is flexibility on different types of shares and attached economic or voting rights. Transfer of shares can be restricted for up to 10 years – ideal for JVs.</li> </ul> <p><b>TAX AND EXCHANGE RULES</b></p> <ul style="list-style-type: none"> <li>— Premiums are permitted.</li> <li>— No notary fees or registration tax on transfer, but registration tax will be payable on registering any increases of capital in the trade register as described below: <ul style="list-style-type: none"> <li>» Capital increase (0.7 percent)</li> <li>» Premium (up to 0.3 percent)</li> </ul> </li> <li>— Funding by shareholders or companies abroad can be made by loans following specific exchange regulations and by capital injections.</li> <li>— Transfer pricing and thin capitalization rules apply.</li> </ul>	<ul style="list-style-type: none"> <li>— No minimum capital</li> <li>— On capitalization, a bylaw amendment is required only if there are insufficient shares in reserve.</li> <li>— A third of all subscribed capital must be paid on issue of shares, with remainder payable in no more than one year.</li> <li>— Some flexibility on different types of shares and attached economic or voting rights</li> </ul> <p><b>TAX AND EXCHANGE RULES</b></p> <ul style="list-style-type: none"> <li>— Premiums are permitted.</li> <li>— No notary fees or registration tax on transfer, but registration tax will be payable on registering any increases of capital in the trade register as described below: <ul style="list-style-type: none"> <li>» Capital increase (0.7 percent)</li> <li>» Premium (up to 0.3 percent)</li> </ul> </li> <li>— Funding by shareholders or companies abroad can be made by loans following specific exchange regulations and by capital injections.</li> <li>— Transfer pricing and thin capitalization rules apply.</li> </ul>	<ul style="list-style-type: none"> <li>— No minimum capital</li> <li>— Each increase of capital or transfer of quotas requires a bylaw amendment and notary fees and registration tax.</li> <li>— Capital must be fully paid at all times.</li> <li>— No flexibility as to voting or economic rights of quotas</li> </ul> <p><b>TAX AND EXCHANGE RULES</b></p> <ul style="list-style-type: none"> <li>— Premiums are permitted.</li> <li>— Notary fees and registration tax of approximately 1 percent is payable on all increases or transfers of quotas.</li> <li>— For capital increases, the registration tax will be payable as described below: <ul style="list-style-type: none"> <li>» Capital increase (0.7 percent)</li> <li>» Premium (up to 0.3 percent)</li> </ul> </li> <li>— Funding by shareholders or companies abroad can be made by loans following specific exchange regulations and by capital injections.</li> <li>— Transfer pricing and thin capitalization rules apply.</li> </ul>	<ul style="list-style-type: none"> <li>— No minimum capital</li> <li>— A branch has assigned capital and supplementary investment to assigned capital.</li> <li>— Each increase to assigned capital requires adoption of board resolutions abroad and a bylaw amendment.</li> <li>— Increases in supplementary investment can be made in cash from abroad. This is ideal for funding cost centers. Other than an annual registration, there are no formalities.</li> </ul> <p><b>TAX AND EXCHANGE RULES</b></p> <ul style="list-style-type: none"> <li>— Notary fees and registration tax amounts to approximately 1 percent of the value of increase of assigned capital. It is non-payable on increase of supplementary investment.</li> <li>— Funding by related companies abroad can be made by loans following specific exchange regulations or by capital injections by the home office, but usually the supplementary investment account is used.</li> <li>— Transfer pricing and thin capitalization rules apply.</li> </ul>
INCOME TAX DIFFERENCES	<p>Subsidiaries are taxed on worldwide income at 25 percent income tax rate for FY 2014.</p> <p>There is an additional income tax called CREE calculated at 9 percent rate for 2014 which is intended to fund certain employee contributions.</p>	<p>Subsidiaries are taxed on worldwide income at 25 percent income tax rate for FY 2014.</p> <p>There is an additional income tax called CREE calculated at 9 percent rate for 2014 which is intended to fund certain employee contributions.</p>	<p>Subsidiaries are taxed on worldwide income at 25 percent income tax rate for FY 2014.</p> <p>There is an additional income tax called CREE calculated at 9 percent rate for 2014 which is intended to fund certain employee contributions.</p>	<p>Branches are taxed only on Colombian source income at 25 percent income tax rate for FY 2014.</p> <p>There is an additional income tax called CREE calculated at 9 percent rate for 2014 which is intended to fund certain employee contributions.</p>
BENEFITS FOR SMALL COMPANIES	<p>There are incentives for small companies that have up to 50 employees and a net worth of less than 5,000 minimum wages (approximately USD1,595,000), consisting of reductions in income tax, reductions in employee contributions and in the trade register fee.</p>	<p>There are incentives for small companies that have up to 50 employees and a net worth of less than 5,000 minimum wages (approximately USD1,595,000), consisting of reductions in income tax, reductions in employee contributions and in the trade register fee.</p>	<p>There are incentives for small companies that have up to 50 employees and a net worth of less than 5,000 minimum wages (approximately USD1,595,000), consisting of reductions in income tax, reductions in employee contributions and in the trade register fee.</p>	

	<b>SIMPLIFIED SHARE COMPANY: “SOCIEDAD POR ACCIONES SIMPLIFICADA”, SAS</b>	<b>CORPORATION: “SOCIEDAD ANÓNIMA”, S.A.</b>	<b>LIMITED LIABILITY COMPANY: “SOCIEDAD DE RESPONSABILIDAD LIMITADA”</b>	<b>BRANCH: “SUCURSAL”</b>
<b>PUBLIC CONTRACTING</b>	Organizational experience can be used from the shareholders of the company during the first three (3) years and financial capability during the first two (2) years, from the incorporation date of the company. It is best to have a higher subscribed and paid – in capital to comply with financial capacity. Technical capacity is measured by the experience of the employees of the Colombian company. Review this issue separately if the company will be participating in public bids.	Organizational experience can be used from the shareholders of the company during the first three (3) years and financial capability during the first two (2) years, from the incorporation date of the company. It is best to have a higher subscribed and paid – in capital to comply with financial capacity. Technical capacity is measured by the experience of the employees of the Colombian company. Review this issue separately if the company will be participating in public bids.	Organizational experience can be used from the shareholders of the company during the first three (3) years and financial capability during the first two (2) years, from the incorporation date of the company. It is best to have a higher subscribed and paid – in capital to comply with financial capacity. Technical capacity is measured by the experience of the employees of the Colombian company. Review this issue separately if the company will be participating in public bids.	Experience and financial capacity of the home office can be accredited in bids for contracts, as the branch and home office are the same entity. This is usually the most favorable type of entity for participation in public bids.

## PART 1: INVESTORS

### 1 FUNDING AND PROCUREMENT

**1.1 Does the law of your jurisdiction allow donors in general (regardless of their legal nature [e.g., straight-out donors or social investors] to fund SIB schemes by directly delivering funds to an Intermediary (either as equity or loans)? Does the law prohibit or limit funding of social service programs? Would the law limit the structure in which the funding is made or the amounts to be funded? What legal formalities would apply to the delivery of funds to an Intermediary (e.g., notarial proceedings)?**

From a tax perspective, it is important to mention that in Mexico it is very common that the entities that provide social services as their main activity have an authorization issued by the Ministry of Treasury ("**SHCP**", after its Spanish acronym) in order to be considered as a social entity with non-profit activities.

Based on the above, there is no limitation or prohibition for funding social services programs in Mexico. If the funds are being delivered directly to an Intermediary, this entity would be responsible of complying with the fund's social purpose in order to avoid the funds being subject to any tax in Mexico.

If the purpose of the social program is to consider the donations as deductible expenses for income tax purposes for the donors, the Intermediary must obtain an authorization before the Ministry of Treasury (SHCP) to be considered as a social entity allowed to provide tax deductible invoices. Please note that there is a limitation to deduct donations to an amount equivalent to 7 percent of the tax profit obtained by the taxpayer in the last fiscal year.

Any donation or funds received by a regular legal entity (without the authorization mentioned above) will be considered as an includable income subject to taxes in Mexico.

On the other hand, the donation or funds could be considered as a deductible item for donors as an investment if the expenses comply with some requirements applicable to investments.

## 1.2 **Given the legal framework under which the government is allowed to enter into agreements, what options, if any, would an investor have when contracting with the government directly?**

Comments to Sections 1.2, 1.6, 2.1, 2.2, 2.3, 2.4, 2.5, 2.6 and 4.1 of this document are based on the principles laid down by the new PPP Law and its Regulations enacted on 16 January 2012 and 5 November 2012, respectively (collectively the “PPP Law”). Although there is no specific regulation for SIBs, this PPP Law framework would appear to be, at least at the federal level, the most adequate legal framework to try to accommodate SIB projects since they are public-private investment schemes. Also note that there are a number of Mexican states that have also enacted their own PPP legal framework and that could serve to launch these SIB projects.

Although not expressly forbidden under the PPP Law, it is not usual for investors to contract directly with the government, not even as a party to a consortium. We understand that, globally, there could be structures that involve the investors at the contracting level from the very beginning. However, there are some papers that expressly state that investors in SIBs projects should not form part in the agreements.

Please note that, as of this date, there have been no projects launched under the PPP Law. Therefore, there are no precedents or case law regarding the interpretation of certain provisions that, in our view, could be used to regulate SIB projects, or alternatively, could be modified to specifically regulate them. Or perhaps, new sections to the PPP Law can be added to give room for the SIB projects.

## 1.3 **Are “hybrid investments” legal or subject to special regulation? Hybrid investments combine equity and debt structures, (i.e., a portion of loaned sums and a portion of direct investment). They could also combine debt and equity; for example, preferred stocks, convertible bonds.**

Other than possible tax impacts depending on whether the investor(s) is (are) as related entities to the services provider or foreign investors, hybrid investments in Mexico are legal and not subject to a special regulation.

## 1.4 **What legal framework applies to debt and equity investments? What limitations or procedures apply to bringing in funds to the jurisdiction?**

From a tax perspective the debts should include an interest rate. The entity that collects interests should consider such amount as an includable income subject to taxes. On the other hand, the entity that pays the interest could deduct such payments if the funds are invested in the main activities of the company.

If the funds are received as an equity investment, and the corresponding capital is increased by the entity, it would not trigger any tax.

### **1.5 For equity investments, are there quantitative/qualitative legal limitations on the repatriation of profits (e.g., foreign exchange regulations)?**

There are no financial regulations that affect the repatriations of profits.

No tax comments.

### **1.6 Would the independent evaluator's report be binding to the government (i.e., assuming that the government is committed to accepting the outcome of the report, could the government challenge such a report)? What are the contract enforcement concerns and mechanisms to ensure that governments follow their commitment to pay according to an independent evaluator's report? Could the government easily challenge the report? What are the risks?**

Please note that although there have been no projects under the PPP Law, other PPP structures have been launched in the past under other legal frameworks for projects involving concessions, long-term service contracts or energy projects. In most of these contracting schemes, the government has offered or has accepted the participation of an independent third party to assess, for instance, technical aspects, costs and expenses, operation and maintenance expenses and compliance with specifications, standards, quality and availability.

If agreed by the parties in the respective agreement, the independent evaluator's report will be binding on each of them, including the government.

This is, in our view, a purely contractual item that requires sufficient legal skills to limit the government's room to challenge such report. In our experience, the parties usually agree to establish a consulting committee to which the parties may resort, in first instance, if one of the terms of the contract is not fulfilled. A second stage would be an independent engineer and the last resort would be to initiate litigation or, in its case, arbitration, if so agreed by the parties.

It is highly relevant that the independent evaluator is duly appointed and designated in the agreement to have additional elements to support the government's acceptance of the said designation and of any of its/his/her resolutions.

However, there seems to be no legal mechanisms that would impede the government from challenging the report itself and rejecting the payment. Yet, Mexican law would allow the contractor/Intermediary to collect financial costs if the government does not pay on time. Usually, the Mexican government does not default in its payments, especially when investors are involved, although certain delay can take place.

## 2 TAX ASPECTS

### 2.1 What tax rules apply to the funding provided by investors (either donations, loans or equity)? Please consider both loans and equity contributions. Would withholdings apply to the repayment of capital/interest, or dividends/repatriation of equity?

Please see our response included in **Section 1.1** to understand the general tax rules applicable to donations and funding.

Please see our response included in **Section 1.4** to understand the general tax rules applicable to loans or equity.

If the repayment of capital/interest/dividends is carried on with foreign entities or individuals, a withholding of taxes should apply. The corresponding withholding tax rate would, on a case-by-case basis, depend on the concept and transaction.

### 2.2 Does the Jurisdiction have international investment agreements, preferential trade or double taxation treaties in force? Are there any on the way of becoming effective (e.g., being negotiated, pending ratification, etc.)?

Mexico has around 30 international investment agreements, and around 52 international agreements for the avoidance of double taxation and the prevention of fiscal evasion that includes a preferential withholding tax rate on the concepts abovementioned.

### 2.3 Are there tax incentives/breaks for socially oriented investing? How cumbersome is the process for obtaining/collecting these incentives?

As we have previously mentioned, there is a tax incentive to consider the donations as deductible expenses for income tax purposes for the donors, in case the Intermediary has an authorization from the Ministry of Treasury (SHCP) to be considered as a social entity.

The process of obtaining this authorization is not easy, since a lot of requirements should be complied with.

### 2.4 Is it possible to write off losses or to reframe a failed investment in SIBs as a grant/donation? If so, would the grant/donation be subject to taxes?

If the donations or funds are invested in a social entity with the corresponding authorization, those funds will be considered as deductible expenses for income tax purposes.

On the other hand, if the donation or funds are contributed in a regular legal entity, those funds will be considered as a deductible investment. Therefore, it is not possible to write off losses or to reframe a failed investment.



## PART 2: GOVERNMENT

### 1 What is the general structure of the state in your jurisdiction? What degree of autonomy do government entities have for contracting?

The Federal Public Administration is centralized. Depending on the subject matter, contracting can take place at the federal level, or at local or municipal levels, respectively. Also, under the PPP Law, its provisions will apply to all ministries and agencies of the Federal Administration. However, such provisions will also apply to local governments and municipalities and their respective agencies, when they carry out projects with federal funds.

In general terms, local entities and municipalities are free to contract with third parties within their scope of jurisdiction without requiring federal intervention. In some cases, they would need approval of their local congress.

For instance, there are federal prisons and there are state and municipal prisons. If, for example, the SIB project would deal with reoffending, then the project could be launched at any of the three levels, provided the respective level has sufficient resources.

Similar cases arise regarding education and health.

Overall, the federal government, acting through the Social Development Ministry, is the entity that is in charge of social development and the one that has all the relevant social programs nationwide (combating poverty, protection of the most vulnerable population, childhood and senior citizen rights, and disabled citizens).

The Mexican Constitution defines the scope of action of the federal government, the local governments and the municipalities. For instance, municipalities would have jurisdiction on, among others: (i) drinkable water; (ii) sewage; (iii) treatment and disposal of residual waters; (iv) public lighting; (v) garbage handling and disposal; and (vi) cemeteries.

On the other hand, the Federal Congress is expressly authorized to regulate, among others, oil and gas, mining, explosives, cinema industry, financial services, power, immigration, telecommunication, internet and foreign investment.

By legal principle, the Constitution provides that all those faculties not expressly allocated to the federation will be under the jurisdiction of the local governments. However, the federation may transfer certain faculties to the states and municipalities as per agreements signed between them.

**2 Do applicable public procurement rules authorize the implementation of an SIB scheme, i.e., funding social programs by means of an agreement between a government agency and an Intermediary, in which payment from the government would be entirely contingent on the organization achieving measurable and positive social outcomes?**

The PPP Law does not contain specific bidding rules for a project. It does not specifically contemplate SIB projects either.

However, under the PPP Law, there could be room for manoeuvre to accommodate the SIBs. Although SIB projects would not fall entirely under the definition of a PPP project, SIBs would still contain a number of elements that have connection with, or that share principles of the, PPP projects, including flexibility.

As mentioned above, the PPP Law would seem to be, in our opinion, the most suitable and existing legal framework that could be used to structure SIB projects. The PPP Law has very broad language and would seem to allow the flexibility that SIB projects require, through the passage of time, to become successful.

**3 How does the government of the jurisdiction contract social services? Is public procurement subject to special rules or would it be subject to general and commercial law rules? Is there flexibility in the performance and supervision of contracts by government?**

The government may carry out social assistance services directly or, in its case, through the states or municipalities, or by means of public and private institutions, by entering into respective agreements.

Currently, the Law for Social Assistance/Support does not expressly contemplate the procurement of social services. However, the PPP Law expressly regulates contracting procedures and establishes the public bidding, restricted invitation and direct award.

The public procurement modalities are laid down in the PPP Law, but the procurement procedures will be conducted depending on the subject matter.

No commercial law rules will apply to the procurement procedures, only administrative regulation such as the PPP Law.

In fact, one of the advantages of the PPP Law is precisely its flexibility at the time of negotiating and signing contracts.

Also note that under the PPP Law, there is an additional mechanism to achieve procurement that is the non-solicited proposal by means of which the private sector can make project proposals to the government.

**4 May an Intermediary tender for both design and implementation stages or would there be impediments because of conflict of interests? Would it be possible to combine direct contracting or PPPs with public procurement and, thus, avoid the conflict of interests issue (i.e., Intermediary would either design or implement under a PPP or direct contract and, thus, be able to tender for the remaining stage.)?**

In the first instance, the PPP law states that the projects will be integral or global, unless implementation will take place faster and with more order, if divided. Following this principle, an Intermediary should be able to participate in both stages.

However, the government may contract the design services separately under the Acquisitions, Leases and Services of the Public Sector Law, if that is the most convenient path. This law also states that companies that intend to participate in a contracting procedure, but that have previously participated in a contract related to services such as technical analysis, quality control, preparation of specifications or any document related to the process in which they intend to participate, will not be able to participate if, by virtue of the said previous agreement, they had access to privilege information to which the other bidders will not have access.

However, this provision is not contained in the PPP Law.

**5 Does annual budgeting apply? If so, are there legal mechanisms to ensure future payments? Can these mechanisms commit future administrations? Where the law does not readily allow for future payments, could trust structures or special vehicles be set up to make up for any shortfalls in the law?**

Yes, annual budgeting applies. However, for ensuring future payments for projects that exceed one or more fiscal years, the applicable legal mechanism are the multi-annual budgets (which have a preferential treatment on the expenses) and they can commit future administrations.

For instance, the PPP Law establishes that all multi-annual budgets for PPP projects must be previously approved by the House of Representatives (*Cámara de Diputados*), in line with the provisions of Articles 32 and 34 of the Federal Budget and Fiscal Responsibility Law.

**6 What happens if a government entity does not execute the whole of its annual budget? Would there be any negative consequences for the entity? If so, would there be legal mechanisms to enable the “freezing” of budget funds?**

The entity will have to reimburse the balance of all non-documented and due and payable expenses to the Federal Treasury.

Public-private projects are, in nature, long term and, therefore, multi-annual budgets are established to secure payment preference.

## PART 3: INTERMEDIARY

### 1 **If the Intermediary carries out activities as simply an advisor, would the law require the Intermediary to set up a permanent presence in the jurisdiction? If the Intermediary is receiving and administering investors' money, would the law require the Intermediary to set up a specific type of entity in the jurisdiction?**

Considering that the Intermediary shall only be an advisor, the Mexican law does not require the Intermediary to set up a permanent presence in Mexico to provide advisory services within Mexican territory.

This is in the understanding that the Intermediary may carry out such advisory activities by either of the following vehicles:

- (i) Directly by a foreign entity

**NOTE:** If the services will be provided within Mexican territory, this approach should be analyzed from a Mexican tax perspective, since it may trigger a permanent establishment in Mexico for tax purposes.

- (ii) By a branch of the foreign entity
- (iii) By a Mexican subsidiary of the foreign entity

### 2 **What types of entities are available in the jurisdiction?**

#### MEXICAN ENTITIES

In Mexico there are many types of companies, however, most of them are not commonly used since they impose restrictions to the shareholders or unlimited liability of their shareholders. Therefore, please find below a brief description of the most common types of Mexican entities used in practice:

*Sociedad de Responsabilidad Limitada* ("S. de R.L.") and *Sociedad Anónima* ("S.A.")

These entities have the same tax treatment and obligations in Mexico. From a liability perspective, both entities bind their partners or shareholders equally, since the partners or shareholders are responsible for the company's liabilities up to the amount of their participation. Furthermore, partners or shareholders of both types of entities may be liable with respect to the tax contributions generated as a result of the company's activities during the time they had such capacity as partners or shareholders. We understand that from a US tax standpoint, an S. de R.L. may be treated as a pass-through entity for US tax purposes and, therefore, may offer some US tax benefits.

The incorporation, corporate structure and operation of both companies are similar. However, they have certain differences, which are described, in the following chart:

S. DE R.L.	S.A.
The minimum fixed capital stock is MXN1.00 (without withdrawal right).	The minimum fixed capital stock is MXN1.00 (without withdrawal right).
The capital stock is divided in equity quotas.	The capital stock is divided in shares.
The minimum number of partners is two (2) and the maximum number of partners is 50.	The minimum number of shareholders is two (2) and there is no maximum number of shareholders.
The equity quotas may be documented by non-negotiable Equity Quota Certificates, however, such certificates does not represent the participation in the capital and may not be a suitable proof of the ownership of capital (are non-negotiable).	The shares are represented by negotiable Share Certificates.
Any transfer of equity quotas requires authorization from the partners.	The transfer of shares requires no authorization, unless provided for in the bylaws.
The company is managed by one or several "managers," which comprise a board of managers.	The company is managed either by a "sole director" or a "board of directors."
It does not require the appointment of a statutory auditor (examiner).	It requires the appointment of at least one statutory Auditor whose activity will focus on the company management supervision. Certain law requirements and restrictions to be a statutory auditor apply.
There is only one type of partners meeting that can deal with all matters.	Mainly, there are two types of shareholders' meetings: ordinary and extraordinary. The matter to be discussed determines the type of the meeting to be held. In addition, special shareholders' meetings are set forth by the law when different clauses or series of shares exist.
This type of entity is not allowed to participate as an issuer of stock in the Mexican Stock Exchange.	This type of legal entity is authorized to become a public company under Mexican law.

Please note that the foregoing comparison refers mostly to corporate issues. As you may see, one entity does not offer substantial benefits over the other.

## INCORPORATION PROCESS

Please find below the steps that must be followed in order to proceed with the incorporation of a new company:

- A. **FOUNDING MEMBERS** – The name of two members will be needed, since according to the law, these types of companies need at least two partners/shareholders in order to be incorporated. Those members may be companies or individual persons.
- B. **A PERMIT FROM THE MINISTRY OF ECONOMY ("ME")** approving the company's name must be obtained. In order to obtain this permit, a formal request must be made and three or four alternative names should be submitted for the company. After verifying that one of the names is not in use, the ME will issue the corresponding authorization in order for the company to be incorporated. If the corporate name of the new entity is similar to the name of another company of the same corporate group, an authorization of the other company should be filed.

### C. PREPARATION OF THE ARTICLES OF INCORPORATION AND BYLAWS

#### D. FORMALIZATION OF THE ARTICLES OF INCORPORATION AND BYLAWS OF THE COMPANY

– For such purposes, the founding members must appear before a Mexican notary public. Those members may be represented by attorneys of our Firm, however, we will need to have the corresponding powers of attorney for such purpose that must be notarized and apostilled (abroad) and then formalized by a Mexican notary public.

- E. Once the new company has been incorporated, its Articles of Incorporation and bylaws must be **REGISTERED WITH THE PUBLIC REGISTRY OF COMMERCE** while the company must be registered with the local tax authorities and the National Registry of Foreign Investments.
- F. If applicable, the company must also be **REGISTERED WITH THE SOCIAL SECURITY INSTITUTE (“IMSS”, after its Spanish acronym), the WORKER’S HOUSING INSTITUTE (“INFONAVIT”, after its Spanish acronym), and the GENERAL IMPORTERS REGISTRY**, among other government agencies.
- G. Upon incorporation and obtaining a tax ID number, a bank account may be opened on behalf of the company.

### BRANCH OF A FOREIGN ENTITY

The Mexican law provides that foreign entities may exercise commercial activities within Mexican territory through the establishment of a branch.

According to Mexican law, the branch of a foreign entity is still considered as a foreign entity that has been registered in Mexico to carry out business. Therefore, a disadvantage of the branch versus establishing a Mexican subsidiary would be that the parent company of the branch shall be exposed to unlimited liability for the operations of the branch and for all Mexican employee benefits of the branch, while the subsidiary shall only be liable for its operations (corporate veil).

A branch’s Mexican income tax, value added tax and asset tax obligations are substantially equivalent to those of a Mexican subsidiary.

### PROCEDURE FOR THE ESTABLISHMENT OF A BRANCH

In order to prepare for the registration of a branch, the following procedure would have to be undertaken:

- A. Depending on the country of origin of the company, it should: (i) obtain an authorization from the Ministry of Economy (“**ME**”) to register the bylaws of the company at the Public Registry of Commerce; or (ii) file a notice of establishment of a branch with the ME, along with the corporate documents of the company and the power of attorney of the legal representative (notarized and apostilled).

**NOTE:** We understand that Instiglio has companies in the United States of America and in Colombia. If any of those companies is considering to establish a branch in Mexico, those companies may opt to use the procedure referred in the above paragraph with the number (ii), which is simpler, subject to evaluation.

- B. It should obtain an authorization to be issued by the Ministry of Economy or file a notice of establishment of the branch, if applicable.
- C. The corporate documents of the Branch should be notarized by a Mexican notary public and registered with the Public Registry of Commerce.
- D. Once the Branch is registered with the Public Registry of Commerce, and thus legally established in Mexico, it should also be registered with the National Registry of Foreign Investments.
- E. The Branch should be registered with the taxpayers' federal registry, after which the Branch may open bank accounts in Mexico.

## OTHER TYPES OF MEXICAN ENTITIES

### I. CIVIL ASSOCIATIONS (NON-PROFIT ENTITIES)

A civil association is a group of individuals gathered in a permanent manner to carry out joint purposes, provided that such purposes are legally permitted and not primarily economic in nature.

We understand that the corporate purpose of the Intermediary should have the economic aim of obtaining revenue from its activities and of transferring the income of those to the investors. Therefore, we believe that the corporate purpose of the Intermediary would not fit into the legal structure of an association.

### II. CIVIL COMPANIES

A civil company is a group of individuals gathered in a permanent manner to perform a joint purpose that is mainly economic in nature, but should not be considered a commercial speculation. According to this, civil companies may provide any type of advisory services.

In this regard, please note that only individuals may be partners of a civil company and so, we believe that Instiglio is not qualified to establish a civil company.

The incorporation process of a civil company is similar to the incorporation process of the commercial companies referred to above.

## **3 Assuming that the Intermediary will receive funding (either through equity or loans) and will use them for the advancement of social projects, could the law of the jurisdiction consider that the Intermediary is carrying out financial intermediation activities or any other sort of regulated activity? What thresholds apply (if any) for being considered a regulated entity (i.e., under financial regulations)?**

No regulated financial activity is triggered the way the transactions have been laid out in this document.

#### **4 Does the law of the jurisdiction set forth foreign exchange constraints or mechanisms for remitting money into the jurisdiction and converting it into local currency?**

There are no foreign exchange controls in Mexico.

Notwithstanding, Mexican law provides that any contribution to a Mexican company, including any capital contribution, shall be recognized in the books of the Mexican company in Mexican currency. The exchange rate according to which the contribution shall be made may be freely agreed upon by the company and its shareholder/s making the contribution (which could be the official exchange rate published by the Mexican Central Bank or any other financial or banking institution, provided that such exchange rate is within standard market values).

#### **5 If the Intermediary requires bringing foreign personnel into the jurisdiction, please discuss briefly what types of visas/permits may be required.**

If the Intermediary is not yet set up in Mexico, no salary will be paid to any foreign national by any Mexican entity. In this case, the Intermediary may bring foreign personnel into Mexico as one of the following:

1. Visitors are authorized to perform any legal activities not remunerated by a Mexican source for up to 180 days per trip. They require a visa prior to traveling to Mexico depending on their nationality, and will be granted a Multiple Use Form or *Forma Migratoria Multiple (FMM)* at any port of entry, upon entry. Foreign nationals with FMM forms will have a hard time opening bank accounts, will not be able to pay taxes in Mexico, and will not be able to temporarily import household goods into Mexico.
2. Temporary residents are authorized to perform any legal activity not remunerated by a Mexican source for a period of time of up to four years. Temporary residents are required to obtain a Temporary Resident Visa at any Mexican Consulate abroad, and must exchange the Temporary Resident Visa for a Temporary Resident Form within 30 days of their first trip into Mexico. Foreign nationals with Temporary Resident Forms are able to temporarily import household goods into Mexico and pay taxes. Temporary residents that will remain for more than four years in the country may change their temporary status (while in Mexico) into a permanent one, after their first four years in Mexico.

There is no limit in regard to how many Visitor Visas and/or FMMs, or Temporary Resident Visas and Forms are issued to a specific foreign entity. Mexican Immigration Law contemplates certain limits to the number of visas to be issued and the activities to be performed, but these restrictions are not being applied. They may, however, be applied in the future. In these cases, the tax liabilities of creating permanent establishments in Mexico must be studied.



## **6 Assuming that the Intermediary has been already set up as an entity in the jurisdiction, please discuss briefly what types of visas/permits would be required for it to engage overseas personnel for work in the jurisdiction.**

If the Intermediary is set up in Mexico, salary will be paid to foreign nationals by a Mexican entity. The only option for the Intermediary in this case is to bring foreign nationals into Mexico as Temporary Residents. Temporary Residents that have been previously authorized to receive remuneration in Mexico from a Mexican source are authorized to perform any legal activity in Mexico for a period of time of up to four years. They are required to obtain authorization from the National Immigration Institute in order to be able to receive a Temporary Resident Visa at any Mexican Consulate abroad, and must exchange the Temporary Resident Visa for a Temporary Resident Form within 30 days of their first trip into Mexico. Foreign nationals on Temporary Resident Forms are able to temporarily import household goods into Mexico and pay taxes. Temporary Residents who will remain for more than four years in the country may change their status (while in Mexico) for a Permanent Resident one, after their first four years in the country.

Mexican entities may only hire 10 percent of their workforce as foreign nationals. These exclude general directors, general managers and general administrators. Company doctors must be Mexican, and technicians may only be hired if no Mexican technicians are available, and only for the time it takes to train Mexican nationals. Currently, there is no specific authority that is checking the statuses of technicians in the company. Mexican Immigration Law contemplates certain limits to the number of visas to be issued and the activities to be performed, but these restrictions are not being applied. They may, however, be applied in the future. Companies may use the services of foreign nationals paid by foreign companies abroad without it affecting the percentage of foreign employees that may be hired, as determined above. In these last cases, the tax liabilities of creating permanent establishments in Mexico must be studied.

## **7 Is there any requirement for Intermediary's directors/officers in the Jurisdiction to be national or residents of the Jurisdiction?**

Please note that in accordance with [ARTICLE 7 OF THE MEXICAN FEDERAL LABOUR LAW \(FLL\)](#) the Employer has the obligation to hire 90 percent of Mexican citizens. Furthermore, for those professional and technical positions, the employer has the obligation to hire Mexican citizens, except there are no employees for such specialized activity, case in which the employer may hire foreigners, on a temporary basis, as long as such foreigners do not represent more than 10 percent of employees hired for such specialized activity. The Employer and the foreign employees will have the jointly liability to train the Mexican employees regarding such specialized activity.

Finally, please note that the abovementioned provisions do not apply to general managers and administrators.

No special requirements are needed, other than any foreign national who will act as a director/officer and must have legal immigration status in Mexico, with an adequate visa and/or immigration form.

## PART 4: SERVICES PROVIDERS

### **1 Assuming that the Intermediary signs a contract with the government, would the law allow the Intermediary to freely choose and contract with the service provider? Would the contract with the government restrict the choice of service provider made by the Intermediary?**

This will depend on how the SIB project tender was launched, but, initially, our opinion is that it will not. Especially, in this kind of project, where the core is precisely the rendering of the services.

In our experience, entities may request that bidder provide information regarding subcontractors and to evidence their experience upon the submission of the proposals, for the entity to validate, among others, such subcontractor/Service Provider.

In other cases, subcontracting activities are specifically allowed, but the subcontractor shall be previously authorized by the entity, at the time the awarded bidder knows its identity.

The contract may, in fact, contain limitations to subcontracting and to the identity and credentials of the Service Provider.

Therefore, in our view, there could be three options: (i) that the Intermediary and the Service Provider jointly participate in the contracting process as a consortium; (ii) that the identity of the Service Provider and its credentials form part of the bidding proposal filed by the Intermediary, for the eventual approval by the entity as part of the award; and (iii) that the allowed subcontracting activities are detailed as part of the bidding rules, but that the entity needs to authorize such subcontractor/Service Provider.

In our experience, it is not common for the government entities to grant *carte blanche* to subcontract with third parties. Also, the Intermediary should ensure that such Service Provider is not banned or restricted to contract with the government because of previous breaches or illegal acts.

### **2 Is there a substantial risk that services providers' personnel could be re-characterized as employees of the Intermediary? What mechanisms are available for reducing/managing this risk?**

Please note that on 1 December 2012, a reform to the FLL came into effect, and it contains several provisions that regulate the outsourcing scheme.

This amendment, defined in [ARTICLE 15-A](#) the outsourcing scheme as one by which an employer, which is the contracting party: renders services with its own employees in favor of a contractor, individual or legal entity; determines the activities to be carried out by the contracting party; and supervises the same in the performance of the works or services.

This kind of work should meet the following conditions:

- a) It cannot cover the totality of the activities, nor be it be the “same or on the overall, similar,” to those that are carried out in the workplace.
- b) It should justify its customized character.
- c) It cannot be similar to the tasks being carried out by the rest of the employees at the contracting party’s service.

If all of these conditions are not met, the contractor will be considered the employer for all legal effects set out in the FLL, including an employer’s social security obligations.

Taking into consideration the referred legal provisions, it is necessary to verify if the Intermediary will determine the services rendered by the Service Provider, and if the Intermediary will be supervising such services, in order to determine whether such companies will be under an outsourcing scheme. If that is the case, it will be important to verify if, in a specific case, the Intermediary can comply with the three conditions referred to in Sections [a\)](#), [b\)](#), and [c\)](#) of Article 15-A of the FLL, in order to reduce the risk of the Intermediary being mistaken for the employer of the Service Provider’s employees.

If the Intermediary refuses to determine the tasks of the Service Provider as a contracting party, and will not supervise them in the performance of the services, the outsourcing scheme will not be configured and consequently, it will not be necessary to follow the outsourcing provisions referred to in the FLL. In this case, there will only be joint liability between the Service Provider and the Intermediary, in the event the Service Provider does not comply with its labor obligations toward its employees, in accordance with [ARTICLES 12, 13, 14 AND 15 OF THE FLL](#).

On the other hand, it is important to mention that in February 2012, the Third Collegiate Court on Labor Matters of the First Circuit issued the a court precedent, which provides that whenever a company provides a work force through the execution of a professional service agreement, or of another nature, and the other party provides the infrastructure and capital, and as a result, the good or service is produced, both parties constitute an economic unit in terms of [ARTICLE 16 OF THE FLL](#). Therefore, both parties are responsible for the labor relationship with the employee.

# SOUTH AFRICA

## PART 1: INVESTORS

### 1 FUNDING AND PROCUREMENT

- 1.1 Does the law of your jurisdiction allow donors in general (regardless of their legal nature [e.g., straight-out donors or social investors] to fund SIB schemes by directly delivering funds to an Intermediary (either as equity or loans)? Does the law prohibit or limit funding of social service programs? Would the law limit the structure in which the funding is made or the amounts to be funded? What legal formalities would apply to the delivery of funds to an Intermediary (e.g., notarial proceedings)?**

From a financial services regulatory perspective, there is nothing that prohibits donors from funding SIB schemes by delivering funds to an Intermediary. No legal formalities (such as notarial proceedings, stamping, etc.) would apply to the delivery of funds to an Intermediary.

- 1.2 Given the legal framework under which the government is allowed to enter into agreements, what options, if any, would an investor have when contracting with the government directly?**

As a starting point, it is worth noting that the term “government” is a generic term that could, in the South African context, encompass a very wide range of actors, from state departments, provinces, ministers and government officials to state-owned entities that exist as incorporated juristic persons in their own rights.

One of the fundamental principles that is enshrined in the [CONSTITUTION OF SOUTH AFRICA, 1996 \(“THE CONSTITUTION”\)](#) and applies to all government conduct is the principle of legality, which is a central tenet of the rule of law. In essence, the principle of legality dictates that all exercises of public power must be authorised by law. Accordingly, the ability of any one of the actors that comprise a government to enter into an agreement will be a question that will depend on the actor in question, as well as on the subject matter and nature of the agreement concerned.

Accordingly, whether a contract can be entered into by a particular government actor depends on whether the actor has the authority to do what is contemplated in the relevant contract and further, to enter into a contractual relationship with third parties in respect of the particular subject matter. The powers of a particular government actor are thus in most cases determined in its governing statute or founding instrument. In

some cases, the powers of a government actor may be determined with reference to the doctrine of implied powers, but this will also be a question of fact.

In addition to the above, we note that insofar as any agreement being entered into by the government amounts to contracting for goods or services, the provisions of [SECTION 217 OF THE CONSTITUTION](#), which apply to most organs of state, would be triggered.

Section 217 of the Constitution provides that when an organ of state contracts for goods or services, it must do so in accordance with a system that is fair, equitable, transparent, competitive and cost effective (“the five principles”).

Importantly, the term “organ of state” is defined in [SECTION 239 OF THE CONSTITUTION](#) as:

- a) any department of state or administration in the national, provincial or local sphere of government; or
- b) any other functionary or institution –
  - i. exercising a power or performing a function in terms of the Constitution or a provincial constitution; or
  - ii. exercising a public power or performing a public function in terms of any legislation,

but does not include a court or a judicial officer.

In our opinion, an agreement entered into by the government in terms of which it pays directly or indirectly for the performance of some social service would most likely fall within the ambit of Section 217 of the Constitution as contracting for services, and would therefore have to follow a process that complies with the five principles.

The most effective manner in which the government can give effect to the five principles is by conducting an open and public tender process. This process essentially involves the government advertising a tender and inviting suppliers to bid for the said tender. The bids are then evaluated and one (or more as the case may be) of the bidders is awarded the tender and a contract is concluded. Only once a tender has been awarded does a legally enforceable contract come into being.

After the award of the tender, the successful bidder and the organ of state may negotiate the terms of the contract to be concluded between them, to the extent that such negotiation was envisaged in the tender documents. The general position, however, is that the negotiated terms cannot materially differ from what was put out to tender. If negotiations result in terms that differ materially from those in the original tender, an aggrieved party may approach a court to challenge the contract as being contrary to the five principles. The terms of the final contract must therefore reflect those in the tender document as much as is reasonably possible. The government therefore bears the primary responsibility for determining the terms of the contract when it creates the tender document.

Notwithstanding the above, there are circumstances in which the government may deviate from the traditional tender process when contracting for goods and services, but such deviation must nonetheless be in line with Section 217 and be reasonable in the prevailing circumstances. This means that a process that is analogous to a tender process and that meets the requirements of Section 217 is permitted.

The tender process may be replaced by a different process where the tender is of a low value. It may also be impractical for the government to enter into a tender process with competitive bids in the case of an emergency or where there is only one supplier of the goods or services. An emergency situation may be where human life is at risk, there is imminent danger or where essential services will be compromised.

It is important to note that it will be closely scrutinised whether there is an actual emergency or a true sole supplier in any particular instance where a tender process is not followed.

Finally, we note that there is also a possibility of the government contracting for goods and services pursuant to a so-called “unsolicited tender.” Unsolicited tenders occur when a tender is received outside of the normal processes, in that the private party approaches the government with a proposal as opposed to being invited to bid by the government. The rules surrounding unsolicited tenders are stringent in light of the threat that unsolicited tenders present to the five principles, especially fairness, transparency and competitiveness. The general rule is that the government should not entertain such tenders, but exceptions exist, such as when the contractor is the sole supplier of the goods or services, the goods or services are unique and beneficial, or where there will be cost advantages for the state beyond those that would flow from a tender process. There are numerous processes and criteria that must be complied with in order for an unsolicited tender to be considered.

Once a contract has been entered into with the government through the appropriate process, it becomes enforceable, like any other private law contract. The government is bound to the contract in so far as the contract is not impossible, unlawful or has been entered into without the required authority. As shall be discussed below, where the government wishes to set aside a contract, it must ordinarily approach a competent court to do so.

### 1.3 Are “hybrid investments” legal or subject to special regulation? Hybrid investments combine equity and debt structures, (i.e., a portion of loaned sums and a portion of direct investment). They could also combine debt and equity; for example, preferred stocks, convertible bonds.

We understand “hybrid debt instruments” to be instruments that have characteristics of both debt and equity.<sup>1</sup> Typical examples of debt instruments would be debentures, bonds and notes, while typical equity instruments would be ordinary shares. Various factors and tests have been adopted to distinguish debt from equity, often in the context of tax law as the classification of an instrument as one or the other often has important fiscal consequences. For instance, in the 2012 US case of *Hewlett-Packard Co v Commissioner*<sup>2</sup>, the court outlined the following key factors, amongst others:

- the presence or absence of a maturity date on an instrument;
- the source of the payments
- the right of the holder of the instrument to enforce payment
- the right to participate in management
- the status/ranking of the instrument as compared to regular corporate creditors of the company; and
- the intent of the parties for the instrument (i.e., issuer and holder)

In March 2011, new standalone rules for pure debt instruments were introduced by the Johannesburg Stock Exchange (**JSE**) in its Debt Listings Requirements. Subsequently, a number of companies have sought the advice of the JSE on how to classify certain instruments that straddle the line between debt and equity. This has led to new rules on hybrid debt instruments. The new **SECTION 20 OF THE LISTINGS REQUIREMENTS** defines “hybrid financial instruments” (**HFIs**) as “securities that portray characteristics of both debt securities and equity securities.” Under the JSE Listings Requirements, “equity securities” are equity shares, securities convertible into equity shares and equity instruments. In turn, “equity share capital” is a company’s issued share capital, excluding any convertible securities, equity instruments and any other securities that are regarded as debt instruments in terms of IFRS or the **COMPANIES ACT, NO. 71 OF 2008** (the “**COMPANIES ACT**”). “Equity instruments” are securities with restricted voting rights, but which participate in the distribution of profits in a manner directly linked to the profitability of the company.

As for “debt securities,” these are defined in the Debt Listings Requirements as securities that are designated by the JSE as such from time to time, including, without limitation, debentures, debenture stock, loan stock, bonds, notes, certificates of deposit, preference shares or any other instrument creating or acknowledging indebtedness. In

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<sup>1</sup> For this section we have relied on *Corporate and Commercial Alert* [🔗](#)

<sup>2</sup> 139 T.C. 8 [2012]

this regard, it is notable that certain preference shares would be likely candidates for characterisation as HFIs, as such shares very often exhibit characteristics of both debt and equity. Each case, however, should be analysed on its own merits. Against the above background, the following key points arise from the new HFI requirements:

- HFIs must be freely transferable.
- An existing issuer or an applicant issuer seeking a listing of HFIs on the JSE is required to comply with and satisfy all applicable JSE Listings Requirements in addition to the provisions set out in Section 20.
- The criteria for the listing of new HFIs are that the JSE must be satisfied with the structure of the HFI; the pricing of the HFI must be clearly determinable; 20 percent of the HFIs must be held by the public; and the number of public HFI holders must be at least 50.
- The issuer is required to comply with Section 3 of the JSE Listings Requirements, which contains various continuing obligations pertaining to, inter alia, financial disclosures, rights of holders of securities, shareholder spreads, director dealings and communications with holders of securities. However, the following are important exclusions with respect to HFIs:
  - » The requirement that voting rights within the same class of security are the same. Note however that if the instrument happens to be a “share” as defined in the Companies Act, [SECTION 37](#) of that Act requires that all shares in the same class have identical rights.
- The requirement that all securities in a class shall rank *pari passu*. Further, they contain a general pre-emptive right in favour of existing holders of equity securities where the company proposes to issue fresh equity securities for cash. These requirements will not apply in respect of HFIs.

For the sake of completeness, we point out that “[hybrid debt instruments](#)” issued by banks that are registered as such under the [BANKS ACT, 1990](#) (the “[BANKS ACT](#)”) are subject to a special legal regime.

#### **1.4 What legal framework applies to debt and equity investments? What limitations or procedures apply to bringing in funds to the jurisdiction?**

##### **EQUITY SECURITIES**

Any primary offering of equity securities (i.e., shares) to the public via remote means or during travel in South Africa where an offeree is situated in South Africa, whether the company is a South African company or not, is subject to the [COMPANIES ACT 2008](#) (the “[COMPANIES ACT](#)”). In terms of the requirements outlined in the Companies Act, the foreign company must file the Memorandum of Incorporation of the issuer of the shares and a list of the names and addresses of the issuer’s directors with the Registrar of Companies within 90 business days before an offer is made to the public, as well as register a prospectus relating to the offer that complies with certain requirements from the Registrar of Companies.



According to the Companies Act, a primary offering for the subscription or sale of shares will not be construed as an “offer to the public” and is therefore not subject to the public offering rules if it falls within one of the following exceptions:

- The total acquisition cost for the client of the subscription for a specific share is at least equivalent ZAR1,000,000;
- The shares are traded on the secondary market.
- The offer is a corporate action (e.g., rights issue, stock split, etc).
- The offer is made to:
  - » a bank (acting as principal) registered or provisionally registered in terms of the Banks;
  - » a mutual bank (acting as a principal) registered or provisionally registered in terms of the Mutual Banks Act 124 of 1993; or
  - » a long-term or short-term insurer (acting as principal) as defined in the Long-Term Insurance Act 52 of 1998 or the Short-Term Insurance Act 53 of 1998 respectively.
- The offer is made to a wholly owned subsidiary of such bank, mutual bank or insurer when it acts as an agent in the capacity of an authorized portfolio manager for a pension fund registered in terms of the Pension Funds Act, 1956 or as manager for a collective investment scheme registered as such in terms of the Collective Investment Schemes Control Act, 2002.
- The offer for subscription is made to any person whose ordinary business, or part of whose ordinary business, is to deal in shares, whether as principals or agents.
- The offer for subscription is made to a financial Service Provider authorized by the Financial Service Board (“FSB”).

An “offer to the public” in terms of the Companies Act includes an offer of securities to any section of the public, whether selected as members or debenture holders of the company concerned, or as clients of the person issuing the prospectus concerned or in any other manner.

An “offer” in relation to securities is defined in the Companies Act as an offer made in any way, including by provisional allotment or allocation, for the subscription for or sale of any securities, and includes an invitation to subscribe to or purchase any security.

The term “primary offering” can be defined as the emission of new issues of investment products, where investment products are sold or placed on the market for the first time (i.e., IPO). An offer in the primary market refers to the initial process whereby the issuer, through whatever means, makes investment opportunities (shares or debentures) available to investors and then receives the proceeds.

The term “secondary offering/market” can be defined as the market where investors purchase investment products from any investor after the emission or issue of the investment products. In the case of an offer in the secondary market, the party offering the securities for sale to the public acts independently of the issuer or on best-execution

basis. Typically, where an offer is made in the secondary market, a prospectus is not required.

“Securities” are defined in the Companies Act, 2008, as including, inter alia, any kind of shares and debentures. Even though commercial papers (bonds, notes and structured products) and collective investment schemes also qualify as “securities,” the public offering rules do not apply.

#### DEBT SECURITIES

The Commercial Paper Regulations, issued under [GOVERNMENT NOTICE 2172 OF 14 DECEMBER 1994](#) (the “Commercial Paper Regulations”) provide that the issue of commercial papers (bonds, notes, debentures and structured products) in South Africa to South African clients by entities that are not registered as banks in South Africa is subject to various conditions that need to be complied with by the issuer of the commercial paper:

Commercial paper may be issued or transferred only in minimum denominations equal to or greater than ZAR1,000,000; and commercial paper may be offered only by a listed public company whose securities are itemised on the main board of the JSE or by a company that, at a point of time not earlier than 18 months prior to the proposed issue of the commercial paper, held net assets with a total value exceeding ZAR100 million, or by any other juristic person authorized by the Registrar of Banks to issue commercial paper.

Furthermore, the Commercial Paper Regulations contain various other requirements relating to: the disclosure of minimum information in a placing document or prospectus relating to the primary offer of bonds and/or notes; the signing and date of the placing document or prospectus; the minimum information to be disclosed on every certificate issued in respect of the bonds and/or notes; the endorsement of bonds and/or notes by a bank; and the prescribed returns by the issuers of the bonds and/or notes.

The issuer specific requirements, however, will not apply if the commercial paper:

- is listed on an exchange;
- is traded on the secondary market;
- is endorsed by a bank (i.e., a South African or foreign bank has given a positive statement in connection with the Commercial Paper);
- is issued for a period of longer than five years; or
- is issued by the South African government or backed by an express guarantee from the South African government.

### 1.5 For equity investments, are there quantitative/qualitative legal limitations on the repatriation of profits (e.g., foreign exchange regulations)?

Exchange control transactions in South Africa are regulated by the Exchange Control Regulations, promulgated in 1961 and by the Exchange Control Rulings, as amended from time to time by way of issued circulars.

According to the Exchange Control Regulations, nonresidents may freely transfer capital in and out of South Africa. However, transactions should be reported to authorities. It is essential for foreign investors to maintain an accurate record of investments to enable the reporting. Dividends paid by a South African subsidiary to a nonresident parent are permitted, subject to a determination being made that the South African company has not “over-borrowed” funds. An auditor’s report may be requested by the bank prior to releasing payment.

**1.6 Would the independent evaluator’s report be binding to the government (i.e., assuming that the government is committed to accepting the outcome of the report, could the government challenge such a report)? What are the contract enforcement concerns and mechanisms to ensure that governments follow their commitment to pay according to an independent evaluator’s report? Could the government easily challenge the report? What are the risks?**

Where the government has entered into a contract, it is, as discussed above, ordinarily bound to the terms of that contract. To the extent that the contract provides for the independent evaluator’s report being binding, the government must uphold its obligations in terms of the contract.

Once it has entered into the contract, the government becomes *functus officio* and as such, the government does not have the power to revoke its own decision and abandon the contract and its obligations thereunder, unless there is statutory authority to do so. The *functus officio* doctrine applies to a decision that is final, in that it has been published, announced or otherwise communicated to affected persons.

If the government wishes to have the contract set aside, it must approach a competent court that can then review the decision to enter into the contract or into that particular term of the contract and set it aside. There must, however, be a basis upon which the contract can be set aside. Such grounds include when the government body did not have the requisite authority to enter into the contract or term (it therefore acted *ultra vires*), where the contract is otherwise unlawful or there has been a fettering of discretion.

With regard to fettering, our law dictates that in making a decision and exercising its powers, the government may not unduly fetter or limit its discretionary powers. The government therefore may not undertake by way of a contract to exercise its discretionary powers in a certain way in the future and thereby limit its ability to apply its mind to the question of what is appropriate and in the public interest at the time when it is called upon to exercise its powers.

Where a contractual obligation conflicts with the rule against fettering, the private and public interests at play must be balanced against each other and a value judgment made as to whether there has been unlawful fettering. Accordingly, the government can agree in the contract to be bound by the evaluator’s report; such agreement must however not amount to the unlawful fettering of a discretionary power of the

government. If such agreement does amount to unlawful fettering, the government would be able to resist any enforcement action brought to compel acceptance of the report by bringing a collateral challenge against the contractual provision that compels it to accept such report. This is because a contract that purports to fetter the discretion of a government actor is unenforceable in South African law. This position is, however, generally limited to contracts that are not commercial in nature. Commercial contracts that fetter the government's discretion will only be unenforceable where there is an incompatibility between the power conferred and the contractual obligations.

Where a government actor has raised unlawful fettering as a collateral challenge to an enforcement action, the court has discretion to grant an order that is just and equitable in the circumstances. This means that the court can adjudicate the matter in such a way so as to not leave the contracting party without any remedy.

## 2 TAX ASPECTS

### 2.1 What tax rules apply to the funding provided by investors (either donations, loans or equity)? Please consider both loans and equity contributions. Would withholdings apply to the repayment of capital/interest, or dividends/repatriation of equity?

South Africa does levy a withholding tax on dividend payments to nonresidents at 15 percent and will soon levy a withholding tax on interest at 15 percent (1 January 2015). The repayment of capital in either situation, either equity or debt funding, would be neutral for tax purposes, but would be subject to exchange control restrictions.

### 2.2 Does the Jurisdiction have international investment agreements, preferential trade or double taxation treaties in force? Are there any on the way of becoming effective (e.g., being negotiated, pending ratification, etc.)?

#### INTERNATIONAL INVESTMENT AGREEMENTS

South Africa is a party to a number of international investment agreements. In 2007, the Department of Trade and Industry, (the DTI) undertook a three-year, extensive, multi-stakeholder review of their 19 Bilateral Investment Treaties (BIT), which were in place. On the basis of the review, the South African government decided in July 2010 that:

- **FIRST**, South Africa would terminate its existing BITs and would only enter into new agreements or renegotiate old treaties if there were compelling economic reasons to do so.
- **SECOND**, South Africa would only enter into new BITs on the basis of a new model that would reduce the risks inherent in earlier generation BITs.
- **THIRD**, while South Africa already provides strong protection to foreign investors, as included in the national legislation, South Africa would clarify that protection in a new Investment Act.
- **LAST**, an Inter-Ministerial Committee would be established and convened by the Minister of Trade to oversee this work.

Pursuant to the review in November 2013, the Minister of Trade and Industry published the [PROMOTION AND PROTECTION ON INVESTMENT BILL](#), ("[THE INVESTMENT BILL](#)"). The Investment Bill proposes a framework for the protection of investors in South Africa, which not only protects investors but allows for the simultaneous protection of South Africa's broader social and economic priorities. The Minister of Trade has stated that they expect the Bill to become law at the end of 2014.

To date, South Africa has terminated its bilateral investment treaties with the following countries: Switzerland, the Netherlands, Spain, Luxembourg, Belgium and Germany. The Minister of Trade and Industry has indicated that more terminations of BITs are to follow.

Pending finalisation of the Investment Bill, several BITs are still in place; accordingly, existing foreign investors continue to receive the benefit of treaty protections.

#### [DOUBLE TAXATION TREATIES](#)

In terms of [SECTION 108 OF THE INCOME TAX ACT](#), the National Executive may enter into double taxation treaties with other jurisdictions.

A number are already in place in South Africa – a few of these agreements deal with sea and air transport only; however, a larger number are general in application.

#### [PREFERENTIAL TRADE AGREEMENTS](#)

South Africa is a party to a number of preferential trade relationships, both at a regional and at a bilateral level. South Africa is further a signatory to the General Agreement of Tariffs and Trade (1047) (GATT), as regulated by the World Trade Organisation (WTO).

South Africa has further negotiated two free trade agreements (FTAs), namely:

- [THE TRADE DEVELOPMENT AND CO-OPERATION AGREEMENT \(TCDA\)](#), which governs South Africa's trade relations and development co-operation with the European Union, (the EU). The TCDA's ratification is still ongoing and the agreement is being provisionally applied. The main objective of the TCDA is to create a free trade area between South Africa and the EU over a 12-year period.
- [SADC FTA](#) – Twelve of the 14 member states of the Southern African development Community (SADC) have officially launched a free trade area. With the goal of eliminating tariffs and trade barriers among member countries, the FTA agreement is part of the SADC's ongoing efforts to deepen long-term integration in order to accelerate economic growth.

South Africa is also the recipient of unilateral preferential trade agreements.

## **2.3 [Are there tax incentives/breaks for socially oriented investing? How cumbersome is the process for obtaining/collecting these incentives?](#)**

While there are no specific incentives to foreign investors on a South African bond or share market, there are some incentives for the entities they invest in, provided they are operating and have taxable income in South Africa.

## 2.4 Is it possible to write off losses or to reframe a failed investment in SIBs as a grant/donation? If so, would the grant/donation be subject to taxes?

Foreign investors might not be subject to tax on the disposal of bonds or shares in South Africa, but this would have to be assessed on a case-by-case basis. A donation by a foreign nonresident will equally not be subject to donations tax in South Africa. If, however, a domestic investor that acquires a bond or a share attempts to convert the investment into a donation, this will trigger a tax event and will not result in a neutral tax result nor will it provide a tax incentive. If money or assets are donated bona fide to a public benefit organisation (PBO) from inception, then it is possible to deduct such donation against taxable income, provided the PBO can issue Section 18A certificates.

## PART 2: GOVERNMENT

### 1 What is the general structure of the state in your jurisdiction? What degree of autonomy do government entities have for contracting?

South Africa is a constitutional democracy, with a three-tier system of government and an independent judiciary. The three-tier governance system comprises the national, provincial and local spheres (levels) of government. These levels all have legislative and executive authorities within their own spheres. Accordingly, each sphere of government enjoys a degree of autonomy to enter into contracts in accordance with existing legislation.

The spheres of government are defined in [SECTION 40 THE CONSTITUTION OF THE REPUBLIC OF SOUTH AFRICA, ACT 108 OF 1996](#), as “distinctive, interdependent and interrelated” and should thus not be seen as hierarchical. Accordingly, the South African Constitution provides for the establishment of three co-equal branches of government, with differing but complementary roles in the South African constitutional system.

#### NATIONAL AND PROVINCIAL GOVERNMENT

Subject to the South African Constitution and existing legislation that is enacted from time to time, the national and provincial spheres of the government have autonomy to enter into contracts that fall within their respective roles and responsibilities. The power to enter into contracts is an element of the executive’s common-law authority, derived from English prerogative powers. Public contracts may also be expressly authorised by statute. In South Africa, the transfer of governmental functions usually takes one of two forms. The first form is through an outsourcing arrangement, which involves the conclusion of a contract between the government and a corporate entity in terms of which the entity undertakes to perform certain traditionally governmental functions. Alternatively, it can also be accomplished through privatisation, which involves the formation of a corporate entity with its own legal personality that is distinct from the government to which responsibility for the performance of a function or provision of

a service is transferred. Outsourcing involves the “contracting out” of specific state functions to the private sector, wherein a person, group, company or entity other than the state is enlisted by means of a contract to provide services directly to the public.

## LOCAL GOVERNMENT

The local government sphere is conferred with contractual autonomy to the extent that it furthers its specific mandate. The South African Constitution provides that the objectives of the local government are to provide a democratic and accountable government for local communities and to ensure the provision of services to communities in a sustainable manner. A municipality must thus strive, within its financial and administrative capacity, to achieve these objectives at the local level. The Constitution further provides that a municipality must structure and manage its administration and budgeting and planning processes to give priority to the basic needs of the community, and to promote the social and economic development of the community. The legislative framework applicable to the local government sphere reiterates this. The [MUNICIPAL SYSTEMS ACT 32 OF 2002 \(MSA\)](#) confirms the primary role of municipal councils as service authorities in deciding on the mechanisms for providing municipal services. The MSA confers a wide degree of autonomy to a local government structure in determining the mechanism to provide a municipal service and accordingly, the extent to which the local government can enter into contracts. The [MUNICIPAL FINANCIAL MANAGEMENT ACT 53 OF 2003 \(“MFMA”\)](#) provides that a municipality may incur expenditure solely in terms of an approved budget and within the limits of the amounts appropriated for the different votes in an approved budget. [SECTION 33 OF THE MFMA](#) makes provision for a municipality to enter into a contract that will impose financial obligations on the municipality beyond a financial year if certain procedural steps are complied with by the municipal council.

Accordingly, a wide degree of autonomy is extended to the local government sphere in that municipalities may contract with third parties in as far as such contractual obligations have: first, the aim of furthering the mandate of the municipality as Service Provider to the local community; second, accordance with the approved budget for the financial year; and third accordance with the applicable procurement legislation and policies.

## **2 Do applicable public procurement rules authorize the implementation of an SIB scheme, i.e., funding social programs by means of an agreement between a government agency and an Intermediary, in which payment from the government would be entirely contingent on the organization achieving measurable and positive social outcomes?**

The statutes that regulate public procurement (i.e., the [PUBLIC FINANCE MANAGEMENT ACT, 1999](#) and Treasury Regulations thereunder; the [MUNICIPAL FINANCE MANAGEMENT ACT, 2004](#) and Regulations thereunder; the [PREFERENTIAL PROCUREMENT FRAMEWORK ACT](#) and regulations thereunder) do not prohibit the implementation of social projects and the like, including SIBs. Whether a particular government actor may enter into



an SIB scheme will depend on its empowering statute as well as other relevant instruments.

Generally, empowering statutes leave a fair degree of autonomy to government actors to perform their mandates as they see fit. Accordingly, it is likely that any actor that is mandated to deal with subject matter that can be subject to an SIB would be able to enter into SIB contracts as envisaged.

In terms of the Treasury Regulations, government departments and other specified entities must have supply chain management policies that regulate, inter alia, when and how they enter into contracts for goods and services. Accordingly, in cases where there is a supply chain management policy, it must also be considered.

Whether the authority to act exists will largely be a question of fact considered in light of the principle of legality.

### **3 How does the government of the jurisdiction contract social services? Is public procurement subject to special rules or would it be subject to general and commercial law rules? Is there flexibility in the performance and supervision of contracts by government?**

There are, broadly speaking, three ways in which government actors can enter into contracts for goods and services: through a public procurement process; through a direct contract; or through a PPP.

As explained above, the government can contract for services through the process of public procurement, which will usually take the form of an open, competitive bidding process. The mechanics and limitations of a contract entered into pursuant to such process have already been discussed above and will not be repeated here.

The main limitations on the government's ability to contract, pursuant to a procurement process are those inherent in the need to ensure compliance with the five principles. The ability to enter into a contract is further limited by the fact that the government is limited when it comes to acting in terms of empowering provisions and in the public interest. Over and above this, both parties are bound to the common law rules of contract, but there is limited opportunity for the parties to renegotiate the contractual terms during the subsistence of the contract. The fact that the government cannot escape the contract without approaching a court to set it aside does however provide a safeguard for the contracting party, as once the government entity is *functus officio* (as explained above), it is bound to the contract.

The possibility of direct contracting has also been discussed at **1.1.2** and is limited to the scenarios discussed in 1.1.2 and even then, with the observance of the formalities set out above.

Our law also provides for the possibility of PPPs that are basically a subset of public procurement processes. PPPs are primarily regulated by **REGULATION 16 OF THE**



**TREASURY REGULATIONS** made under the **PUBLIC FINANCE MANAGEMENT ACT**. A PPP is defined as:

“a commercial transaction between an institution and a private party in terms of which the private party –

- a) performs an institutional function on behalf of the institution; and/or
- b) acquires the use of state property for its own commercial purposes; and
- c) assumes substantial financial, technical and operational risks in connection with the performance of the institutional function and/or use of state property; and
- d) receives a benefit for performing the institutional function or from utilising the state property, either by way of:
  - i. consideration to be paid by the institution which derives from a revenue fund or, where the institution is a national government business enterprise or a provincial government business enterprise, from the revenues of such institution; or
  - ii. charges or fees to be collected by the private party from users or customers of a service provided to them; or
  - iii. a combination of such consideration and such charges or fees;”

A PPP is entered into by way of an agreement entered into by the government entity and the private party after a procurement process, which is in accordance with the five principles and which includes consideration of preferential procurement that has been conducted. The PPP is therefore a contract that must result from a tender process. Where a project can be implemented as a PPP, the accounting officer of the government actor concerned must conduct a feasibility study to determine if the PPP is the appropriate mechanism and after this, various written approvals must be obtained from the National Treasury. The conclusion must also follow the process and formalities prescribed in Regulation 16.

It follows that the PPP will only be binding on the government where the accounting officer/authority of the government actor concerned entered into the agreement and all applicable approval from the National Treasury has been obtained.

As the PPP is a commercial arrangement and the private party takes on the function of the public body in relation to the project, there is a shift of risk, where the private body will assume responsibility for the project. The private party bears financial, technical and operational risk in design, financing, building and operation of the project.

The PPP process is therefore technical and requires numerous processes and approvals as well as places a risk burden onto the private party. The National Treasury may however exempt a government entity from complying with some or all of the requirements under Regulation 16.

**4 May an Intermediary tender for both design and implementation stages or would there be impediments because of conflict of interests? Would it be possible to combine direct contracting or PPPs with public procurement and, thus, avoid the conflict of interests issue (i.e., Intermediary would either design or implement under a PPP or direct contract and, thus, be able to tender for the remaining stage.)?**

When the government puts a contract out to tender, the tender document can specify that a bidder can bid for the whole or part of the tender concerned. There is no reason why a contract put out to tender cannot relate to both the design and implementation stages of a project and it is up to the procurer to determine whether this is appropriate in relation to a particular project or not.

**5 Does annual budgeting apply? If so, are there legal mechanisms to ensure future payments? Can these mechanisms commit future administrations? Where the law does not readily allow for future payments, could trust structures or special vehicles be set up to make up for any shortfalls in the law?**

Annual budgeting does apply to most government actors in South Africa. The only exception are those government entities that do not depend on appropriations from the national revenue for their funds, but rather operate as independent juristic persons that generate their own funds from commercial and other activities. The Minister responsible for a government department or entity must table its annual expected budget at the National Assembly each year for approval and the budget given must contain all expected expenditure for the forthcoming financial year. The entity must then spend in accordance with its budget, as tabled and allocated.

The Public Finance Management Act also regulates government spending and, particularly, spending that has future financial implications. Section 66 provides that where a government actor wishes to issue a guarantee or enter into any transaction that binds or may bind that entity or actor to any future financial commitment, there are certain persons who have to authorise such action. Section 66 therefore prescribes specific persons who can be approached for approval as well as specific processes that must be adhered to in order to make these future financial commitments.

As far as trust structures and special vehicles are concerned, it is unclear to us how these would be implemented and for what purpose. We would thus require further details on how these would operate in order to advise on their permissibility.

**6 What happens if a government entity does not execute the whole of its annual budget? Would there be any negative consequences for the entity? If so, would there be legal mechanisms to enable the “freezing” of budget funds?**

As stated above, government departments must have their annual budgets approved. When an approved budget allocation is not spent, the government department is deemed to be underspending, which gives rise to certain consequences.

**SECTION 214 OF THE CONSTITUTION** provides that parliament must enact legislation on an annual basis to provide for the equitable division and allocation of revenue raised by the different spheres of government. The **DIVISION OF REVENUE ACT (DORA)** is, therefore, reformulated each year to provide for the allocation of revenue. The DORA for the 2014/2015 financial year is in the process of being enacted.

In terms of **SECTION 18(1)** of the **2013 DORA**, the National Treasury has the discretion to, or on request may, stop the transfer of an allocation of revenue to a province or municipality, if it suspects that the province or municipality will underspend on the allocation. When such a decision is made, the National Treasury must give notice in writing, informing the relevant treasury of the action.

When allocations are unspent, they can be apportioned to another province or municipality. This rollover of funds can be requested by a receiving provincial treasury or a national officer. Notice must be given to all relevant parties of the intention to roll over the funds.

The **PUBLIC FINANCE MANAGEMENT ACT** also regulates the under-spending of budgets. In this regard, **SECTIONS 30(2)(G)** and **31(2)(G)** provide for the adjustments of national and provincial budgets that are underspent. These sections state that an adjustment of the budget may be made to the rollover of funds from a preceding financial year. Sections 30(2)(g) and 31(2)(g) must be read with **REGULATION 6.4** of the Treasury Regulations.

Regulation 6.4 allows for funds that have been allocated but not spent to be rolled over to a subsequent year subject to the approval of the National Treasury. There are certain limitations that apply to the rollover of funds. This includes the condition that funds can only be rolled over if an application has been made to the relevant treasury on or before the last working day of April each year. The application must be made in accordance with a format determined by the National Treasury and must state the following: (i) the reasons for which the funds were appropriated; (ii) the reasons for not spending the funds allocated; and (iii) any proposed changes to the funds. A disbursement schedule indicating the month(s) in which the expenditure is expected to be incurred should also be included.

## PART 3: INTERMEDIARY

### 1 If the Intermediary carries out activities as a mere advisor, would the law require the Intermediary to set up a permanent presence in the jurisdiction? If the Intermediary is receiving and administering investors' money, would the law require the Intermediary to set up a specific type of entity in the jurisdiction?

Both advisory and Intermediary services are subject to regulation under the [FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT, 2002](#) (the “[FAIS ACT](#)”). As will be discussed below, a person who provides “advice” or renders “Intermediary service” is required to be in possession of a so-called financial services provider license. It is, however, not necessary to set up a permanent residence in South Africa in order to apply for and be issued with a financial services provider license. In addition, Intermediaries are not required to set up a specific type of entity in South Africa in order to administer to an investor’s money.

[SECTION 7\(1\)](#) of the FAIS Act provides that no person may act or offer to act as a financial services provider unless such person has been issued with a licence under [SECTION 8](#) of the FAIS Act.

A “[financial services provider](#)” (“FSP”) is defined in the FAIS Act to mean any person, other than a representative (i.e., an employee, agent or mandatory of an FSP), who, as a regular feature of the business of such person, furnishes “advice” and/or renders any “Intermediary service” (collectively, “financial services”) to clients in respect of financial products.

It is evident that the FAIS Act is aimed at functions, rather than institutions. The functions must be rendered to a client, performed as part of a person’s regular business and relate to a financial product as defined in the FAIS Act.

A “[financial product](#)” is defined in [SECTION 1\(1\)](#) of the FAIS Act to encompass a broad range of local and foreign securities and financial instruments. The list of financial products includes, inter alia, participatory interests in any local or foreign collective investment schemes (such as mutual funds, unit trusts and open-ended investment companies), shares, stocks and depository receipts in a company other than a share block company, bonds and derivative instruments.

The definitions of “advice” and “Intermediary service” are crucial in determining the ambit of the FAIS Act.

The term “[advice](#)” is defined in the FAIS Act as any recommendation, guidance or proposal furnished, by any means or medium, to any client or group of clients:

- in respect of the purchase of any financial product;
- in respect of the investment in any financial product;
- on the conclusion of any other transaction, including a loan or cession, aimed at the incurring of any liability or the acquisition of any right or benefit in respect of any financial product; or

- on the variation of any term or condition applying to a financial product, on the replacement of any such product, or on the termination of any purchase of or investment in any such product.

These categories are exclusive and will apply irrespective of whether or not the advice is furnished in the course of, or incidental to financial planning in connection with the affairs of the client, or results in such purchase, investment, transaction, variation, replacement or termination, as the case may be, being effected.

SECTION 1(3) of the FAIS Act sets out specific exclusions from the definition of “advice,” which include the following:

- mere factual advice, where such advice is given:
  - » on the procedure for entering into a transaction in respect of any financial product;
  - » in relation to the description of a financial product;
  - » in answer to routine administrative queries;
  - » in the form of objective information about a particular financial product; or
- display or distribution of promotional material;
- an analysis or report on a financial product without any express or implied recommendation, guidance or proposal that any particular transaction in respect of the product is appropriate to the particular investment objectives, financial situation or particular needs of a client (such as research reports).

An “Intermediary service” is defined in the FAIS Act as any act, other than the furnishing of advice, performed by a person for or on behalf of a client or product supplier. The result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product with a product supplier.

It is also defined as having a view to buy, sell or otherwise deal in (whether on a discretionary or nondiscretionary basis) managing, administering, keeping in safe custody, maintaining or serving a financial product purchased by a client from a product supplier or in which the client has invested.

Also defined under the “Intermediary service” is the collecting or accounting for premiums or other monies payable by the client to a product supplier in respect of a financial product.

It also covers the receiving, submitting or processing of the claims of a client against a product supplier.

The exclusions from the definition of “Intermediary service” include any Intermediary service rendered by a product supplier who is authorised under a particular law to conduct business as a financial institution, where the rendering of such service is regulated by or under such law.

A “product supplier” is defined as any person who issues a financial product by virtue of an authority, approval or right granted to such person under any law.

## 2 What types of entities are available in the jurisdiction?

There are various legal entities available in South Africa. [THE COMPANIES ACT 71 OF 2008](#) (the “COMPANIES ACT”) recognises two categories of companies, namely the ‘profit company’ and the ‘non-profitnon-profit company’.

The Companies Act specifies four types of profit companies: (i) private company; (ii) state-owned company; (iii) personal liability company; and (iv) public company. Profit companies are categorised as companies without restrictions on the transferability of their shares and that do not prohibit offers to the public.

### PRIVATE COMPANIES

Private companies have separate legal personality and limited liability. The Companies Act does not require a private company to be comprised of local shareholders or directors. A private company must, however, have a minimum of one shareholder and can have up to fifty shareholders. A private company must have at least one director and the company’s Memorandum of Incorporation (MOI) is required to restrict the right to transfer the shares of the company and prohibit any offer to the public for the subscription of any shares or debentures of the company.

A private company is not obliged to appoint an auditor (unless required to do so in terms of the Companies Act or the company’s MOI), however, the company can elect to comply voluntarily with the accounting requirements contained in Chapter 3 of the Companies Act.

Private companies are identified by the words “Proprietary Limited” or “(Pty) Ltd” after the name of the company and the incorporation of a private company involves the reservation of a company name, the filing of the MOI of the company (the Constitution of a company), written consent of auditors to act for the company (if any), notice of the company’s registered office and the submission of a register of directors. The process of incorporation itself takes, on average, one to two months, although this is largely dependent on the time taken by the companies and the Intellectual Property Commission to effect the registration. According to the Companies Act, the companies and Intellectual Property Commission are tasked with the registration of companies. A company is incorporated by the lodging of prescribed forms to the commission.

Private companies are subject to fewer controls than the other three forms of profit companies.

### PUBLIC COMPANIES

Public companies are liable to shareholders. The management is invested in a Board of Directors. A public company must have a minimum of one shareholder and three

directors. A public company's MOI does not restrict the right to transfer shares of the company. Public companies are identified by the suffix "Limited" or "Ltd."

#### PERSONAL LIABILITY COMPANIES

Companies may be incorporated in terms of [SECTION 8\(2\)\(C\) OF THE COMPANIES ACT](#). In short, companies incorporated in terms of this section provide, in terms of their MOI, that the directors and past directors are jointly and severally liable, together with the company, for any debts and liabilities of the company that are or were contracted during their respective periods of office. Companies incorporated under Section 8(2)(c) are identified by the suffix "Incorporated" or "Inc." This form of business enterprise is most often used by firms of professionals.

#### THE COMPANIES ACT FURTHER PROVIDES FOR EXTERNAL COMPANIES.

A foreign company not wishing to incorporate a subsidiary in South Africa may set up a branch office. The foreign company must register as an "external company" within twenty business days after it first begins to "conduct business, or non-profit/non-profit activities," as the case may be, within South Africa.

According to [SECTIONS 23\(2\) and 23\(2A\)](#) of the [COMPANIES ACT](#), a foreign company "conducts business or non-profit/non-profit activities within the Republic" if that foreign company:

- is a party to one or more employment contracts within the Republic; or
- (subject to [SUBSECTION \[2A\]](#)) is engaging in a course of conduct, or has engaged in a course or pattern of activities within the Republic over a period of at least six months, such as would lead a person to reasonably conclude that the company intends to continually engage in business or non-profit activities within the Republic.

The provision further states that when applying the above test, a foreign company must not be regarded as "conducting business activities or non-profit/non-profit activities, as the case may be, within the Republic" solely on the ground that the foreign company is or has engaged in one or more of the following activities:

- Holding a meeting or meetings of the shareholders or board of the foreign company within the Republic, or otherwise conducting any of the company's internal affairs within the Republic
- Establishing or maintaining any bank or other financial accounts within the Republic
- Establishing or maintaining offices or agencies within the Republic for the transfer, exchange, or registration of the foreign company's own securities
- Creating or acquiring any debts within the Republic, or any mortgages or security interests in any property within the Republic
- Securing or collecting any debt, or enforcing any mortgage or security interest within the Republic
- Acquiring any interest in any property within the Republic

A notarially certified copy of the Memorandum and Articles of Association (constitutional documents) of the parent company must be filed with Companies and Intellectual Property Commission (“CIPC”) to effect registration. Further, an external company must comply with the Companies Act by appointing a South African auditor if required to do so. There is, however, no need to appoint a local board of directors, but simply one person residing in South Africa to accept serving of any notices.

The Companies Act further provides for the establishment of a sole proprietorship. A sole proprietor trades under his/her own name with no separation of assets and liabilities. Sole proprietorship does not give rise to separate legal personality, perpetual succession or limited liability. There are few formal requirements for the establishment and maintenance of a sole proprietorship.

### NON-PROFIT COMPANIES

The Companies Act provides for the establishment of a non-profit legal entity. Non-profit companies are incorporated for a “public benefit purpose”. Non-profit companies must have a public benefit object or an object relating to one or more cultural or social activities, or communal or group interests and must apply all of its assets and income to advance its stated objects. Thus, income and property is not distributable to its members or office-bearers except as reasonable compensation for services rendered.

It is important to note that foreigners who are contemplating investing in the South African economy by establishing a business or by investing in an existing business in the country must apply for a business permit in terms of the Immigration Act. An applicant will be required to invest a prescribed financial capital contribution. [REGULATION 12\(1\) OF THE IMMIGRATION REGULATIONS](#) published under Government Notice R616 in Government Gazette 27725 of 27 June 2005, (the “Immigration Regulations”) provides as follows:

“[12\(1\)](#) an application for a business permit shall be accompanied by a certificate issued by a chartered accountant registered with the South African Institute of Chartered Accountants to the effect that – [sic]

- a) at least R2,5[sic] million in cash;
- b) a capital contribution of at least R2,5[sic] million; or
- c) at least R2[sic] million in cash and a capital contribution of at least R500 000,

originating from abroad, is available to be invested as part of the book value of the business.”



**3 Assuming that the Intermediary will receive funding (either through equity or loans) and will use them for the advancement of social projects, could the law of the jurisdiction consider that the Intermediary is carrying out financial intermediation activities or any other sort of regulated activity? What thresholds apply (if any) for being considered a regulated entity (i.e., under financial regulations)?**

The definition of “Intermediary service” is wide and difficult to interpret. Commentators on the FAIS Act (See Van Zyl Financial Advisory and Intermediary Services Manual Juta 2011:1-14A) believe that for a service to qualify as an “Intermediary service,” it has to be rendered by virtue of a tripartite arrangement in which the Intermediary acts as “go-between” in respect of a relevant “product supplier” and client who invests in a financial product.

It is evident that the FAIS Act is aimed at functions, rather than institutions. The functions must be rendered to a client, performed as part of a person’s regular business and relate to a “financial product” as defined in the FAIS Act.

The FAIS Act seeks only to regulate advisory and Intermediary services rendered in respect of a closed category of “financial products.” Social projects per se are excluded from the definition of “financial product” and the Intermediary would, therefore, not require an FSP license in order to intermediate social projects. If, however, the Intermediary’s actions are aimed at clients entering into transactions relating to financial products such as bonds, notes, shares, derivatives, funds, policies, and the like, the Intermediary will need to be in possession of an FSP license.

**4 Does the law of the jurisdiction set forth foreign exchange constraints or mechanisms for remitting money into the jurisdiction and converting it into local currency?**

SECTION 9 OF THE CURRENCY AND EXCHANGES ACT (ACT NO. 9 OF 1933) empowers the president to make regulations with regard to any matter directly or indirectly relating to, or affecting or having any bearing upon currency, banking or exchanges. Regulations have been made in terms of the Act. Orders and Rules, as amended, are furthermore issued under the Regulations.

Exchange control regulations in South Africa control the flow of money both in and out of South Africa. They affect every transaction, no matter what amount gets transferred and who the sender or recipient of the money is.

The Reserve Bank of South Africa controls and oversees all capital inflow and outflows. The Reserve Bank designates power to so-called authorised dealers who oversee and regulate the market on their behalf.

In terms of the exchange control regulations, the prior consent of the exchange control authorities is required for ‘financial assistance’ granted to a South African resident by a nonresident or an ‘effected person’. ‘Financial assistance’ is widely defined as including

loans, the grant of credit, taking up securities, the conclusion of hire purchase, lease, buyback and leaseback arrangements, discounting, factoring and suretyships.

Nonresidents may, however, bring foreign currency into South Africa. The said foreign currency is convertible into South African Rands at any bank and or at any “authorised dealer.” Confirmation of this conversion should, however, be retained should the visitor want to convert the South African Rands back into foreign currency.

Nonresidents may freely invest in South Africa, provided that suitable documentary evidence is viewed by the bank concerned, in order to ensure that such transactions are concluded at arm’s-length, at fair market related prices and are financed in an approved manner. Such financing must be in the form of the introduction of foreign currency or Rand from a nonresident account (i.e., a Rand account opened by a nonresident at a South African bank). Any income earned on the investment may be transferred abroad. Should a nonresident disinvest from the country, the local sale or redemption proceeds of nonresident-owned assets in South Africa would be regarded as freely transferable.

## **5 If the Intermediary requires bringing foreign personnel into the jurisdiction, please discuss briefly what types of visas/permits may be required.**

THE IMMIGRATION ACT, 13 OF 2002 (“THE IMMIGRATION ACT”) sets out the types of, and the requirements for the granting of, four ‘species’ of work permits that, under the South African law, allow an individual to perform work in South Africa. These are as follows:

- A quota work permit
- A general work permit
- An exceptional skills work permit
- An intra-company transfer work permit

Before dealing with each specific class of work permit, we set out the requirements, in respect of all the work permits, published in the IMMIGRATION REGULATIONS under Government Notice R616 in Government Gazette 27725 of 27 June 2005 (“THE IMMIGRATION REGULATIONS”).

An applicant for either a quota work permit, general work permit, exceptional skills permit or intra-company transfer work permit must submit the following:

- At the discretion of the Director General of the Department of Home Affairs (“the DG”), proof of a valid return air ticket, a deposit or a written undertaking by the employer accepting responsibility for the costs related to the deportation of the applicant and his/her dependent family members, should it become necessary, respectively
- A yellow fever vaccination certificate if he/she travelled or intends travelling from and through a yellow fever endemic area
- A police clearance certificate
- Medical and radiological reports

- Documentation relating to minor dependent children accompanying the applicant
- Documentation relating to his/her marital status or spousal relationship

#### QUOTA WORK PERMIT

A quota permit is issued in accordance with [SECTION 19\(1\) OF THE IMMIGRATION ACT](#) in circumstances when:

- a foreigner falls within a specific professional category, as determined by the Minister of Home Affairs (“the Minister”) at least annually by notice in the government gazette; and
- the number of quota work permits issued for that category does not exceed the quota determined.

From time to time, the Minister of Home Affairs publishes, by notice in the government gazette, the Specific Professional Categories and Specific Occupational Classes. The list contains the most recent list of professional categories in respect of which quota permits may be issued. The Immigration Regulations require an applicant for a quota work permit to provide the DG with: (i) confirmation that the foreigner possesses the necessary qualifications, as certified by the South African Qualifications Authority; (ii) experience for the specific occupation; and (iii) proof that the applicant complies with the registration requirements of the relevant professional body, board or council.

#### GENERAL WORK PERMIT

In terms of [SECTION 19\(2\) OF THE IMMIGRATION ACT](#), a general work permit may be issued by the DG to a foreigner who does not qualify for a quota permit if the prospective employer:

- satisfies the DG that, despite diligent search, it has been unable to employ a person in South Africa with qualifications or skills and experience equivalent to those of the applicant;
- satisfies the DG that the terms and conditions under which he/she intends to employ that foreigner are not inferior to those prevailing in the relevant market segment for citizens; and
- has agreed in writing to notify the DG when such foreigner is no longer employed or is employed in a different capacity or role.

The Immigration Regulations require that an application for a general work permit be accompanied by:

- a contract of employment stipulating the conditions of employment, signed by both the employer and the applicant;
- proof of qualifications as evaluated by the South African Qualifications Authority;
- proof of experience and skills in line with the job offer;
- a letter from the employer motivating why a citizen or permanent resident could not fill the position, as well as proof of efforts made to obtain the services of a citizen or resident, together with particulars of the unsuccessful candidates;

- proof of publication of an advertisement in the national printed media;
- an undertaking by the employer to inform the DG should the applicant not comply with the Immigration Act or leave the employer;
- if required by law, proof of registration with the relevant professional body, council or board;
- full particulars of the employer; and
- a certificate from the Department of Labour or an extract from the database of a salary benchmarking organisation stipulating the average salary earned by employees occupying similar positions in South Africa.

The benefit of a general work permit is that it is not restricted to a specific time period.

#### EXCEPTIONAL SKILLS WORK PERMIT

An exceptional skills work permit, as provided for in [SECTION 19\(4\) OF THE IMMIGRATION ACT](#), may be granted by the DG to a foreign national who is able to demonstrate that he/she possesses exceptional skills or qualifications.

The Immigration Regulations require that an application for an exceptional skills work permit be accompanied by:

- a letter from a foreign or South African organ of state or from an established South African academic, cultural or business body confirming the exceptional skills or qualifications of the applicant;
- testimonials from previous employers and a comprehensive curriculum vitae;
- other proof to substantiate exceptional skills or qualifications, such as publications and testimonials; and
- a letter of motivation indicating that the exceptional skills possessed by the applicant will be to the benefit of the South African environment in which he/she intends to operate.

An exceptional skills work permit may not be issued for a period in excess of three years.

#### INTRA-COMPANY TRANSFER WORK PERMIT

An intra-company transfer work permit may be issued by the DG to a foreign national employed abroad by a business operating in South Africa in a branch, subsidiary or affiliate relationship and as a consequence of his/her employment is required to work in South Africa for a period not exceeding two years, provided that:

- the employer undertakes that it will take prescribed measures to ensure that such foreigner at all times complies with the provisions of the Immigration Act, and will immediately notify the DG if it has reason to believe otherwise; and
- the employer furnishes the prescribed financial guarantees to defray deportation and other costs should such foreigner fails to depart when no longer allowed to be in South Africa.

The Immigration Regulations require that an application for an intra-company work permit be accompanied by:

- the foreigner’s contract of employment with the company abroad; and
- a letter from the company abroad confirming that the foreigner shall be transferred to a branch of that company or an affiliated company situated in South Africa and the South African company confirming the transfer of the foreigner, as well as specifying the occupation and capacity in which that foreigner shall be employed.

**6 Assuming that the Intermediary has been already set up as an entity in the jurisdiction, please discuss briefly what types of visas/permits would be required for it to engage overseas personnel for work in the jurisdiction.**

An Intermediary that has already been set up as an entity in South Africa would only be entitled to employ foreign personnel who are eligible for one of the ‘species’ of work permits described above.

(We note that we are unable to distinguish the difference in respects to **Section 5** and 6 given that an Intermediary is defined in the definitions section of the questionnaire as “the local entity, duly set up in the Jurisdiction....” We accordingly require further clarity.)

We note, however, that there would not be any visa/permit restrictions if the Intermediary is to consult/engage with foreign personnel to provide them with services while such personnel are based overseas and are not entering the jurisdiction.

**7 Is there any requirement for Intermediary’s directors/officers in the Jurisdiction to be national or residents of the Jurisdiction?**

In respect of an Intermediary that is duly incorporated and registered in South Africa, the Companies Act does not prescribe the directors and/or management of a company registered in South Africa be nationals or residents of South Africa. One would, however, only be able to have a foreign office bearer employed by an Intermediary within the jurisdiction once such an office bearer is in possession of a visa/permit as detailed above in **6**.

To the extent to which it is relevant, it is further noteworthy that **REGULATION 12(2)(B) OF THE IMMIGRATION REGULATIONS** provides that a foreign national who makes an application for a business permit in order to invest and or conduct business in South Africa is required to submit “proof of an undertaking that at least five citizens or permanent residents shall be permanently employed.” An Intermediary that is established in South Africa in consequence of a business permit having been issued would accordingly have to comply with **REGULATION 12(2)(B)**.

## PART 4: SERVICES PROVIDERS

### **1 Assuming that the Intermediary signs a contract with the government, would the law allow the Intermediary to freely choose and contract with the service provider? Would the contract with the government restrict the choice of service provider made by the Intermediary?**

When an Intermediary enters into a contract with a Service Provider, the Intermediary will be subcontracting to the Service Provider. While there is generally no prohibition on this, we note that the [PREFERENTIAL PROCUREMENT POLICY FRAMEWORK ACT, 2000](#) ("PPPFA") and the Regulations thereunder provide some restrictions on subcontracting.

The PPPFA is a legislation that regulates the ability of government to implement preferential procurement policies in its procurement of goods and services in order to advance, amongst others, socio-economic development goals and persons who were historically disadvantaged by unfair discrimination on the basis of race, gender or disability. To this end, the PPPFA allows the awarding of points in a procurement process not only with regard to the price offered by a bidder but with regard to a [BIDDER'S BROAD-BASED BLACK ECONOMIC EMPOWERMENT](#) ("B-BBEE") status as determined in accordance with the B-BBEE legislation.

The important thing to note from the regime created under the PPPFA for present purposes is that [REGULATION 11\(9\)](#) of the regulations to the PPPFA provides that a person who is awarded a tender contract cannot subcontract more than 25 percent of the value of the contract to an entity unless such entity has an equal or higher B-BBEE status level. This is the case unless the contract is subcontracted to an exempted microenterprise that has the capability and ability to execute the subcontract. Accordingly, if any contracts awarded to an Intermediary in terms of an SIB scheme involved the awarding of points for B-BBEE, then the restriction set out above will apply to the ability of such Intermediary to freely choose and contract with a Service Provider.

In addition, the ability of the Intermediary to subcontract will depend on whether this was contemplated in the tender documents in terms of which the Intermediary has been appointed.

### **2 Is there a substantial risk that services providers' personnel could be re-characterized as employees of the Intermediary? What mechanisms are available for reducing/managing this risk?**

The risk which exists in South Africa for Service providers personnel to be characterised as employees of the Intermediary can only be assessed on a case-by-case bases after looking at each respective relationship under consideration and the manner and form of each entity. Under South African Labour Law, when one is faced with an enquiry as to whether or not an individual is an "employee" of an entity, one is guided by applicable

statutes, the common law and our case law. The relationship is viewed as a whole and a conclusion is drawn from the entire picture.

There are, however, general considerations and guidelines that one can follow in guarding against the risks of having the personnel of a Service Provider being considered an employee of an Intermediary.

One would begin by examining the agreement of employment entered into between the personnel and the Service Provider. The courts in South Africa have frequently held that classification of such contracts is a matter of substance and not merely of form. Accordingly, the mere fact that the parties have given their contract a particular label is not conclusive. The true nature of the contract is determined from the relationship between the parties.

**THE LABOUR RELATIONS ACT OF 1996 (THE “LRA”)** defines an employee as:

- “a) any person, excluding an independent contractor, who works for another person or for the State, and who receives, or is entitled to receive, any remuneration; and
- b) any other person who in any manner assists in carrying on or conducting the business of an employer.”

**SECTION 83A OF THE BASIC CONDITIONS OF EMPLOYMENT ACT “THE BCEA”** and **SECTION 200A OF THE LABOUR RELATIONS ACT** further provide a statutory presumption that a person earning less than ZAR193,805 per year who works for, or renders services to, any person or entity is presumed, until the contrary is proved, to be an employee, regardless of the form of the contract, if any one or more of the following factors is present:

- The manner in which the person works is subject to the control or direction of the person/entity.
- The person’s hours of work are subject to the control or direction of the person/entity.
- In the case of a person who works for an organisation, the person is a part of that organisation.
- The person has worked for that person/entity for an average of at least 40 hours per month over the last three months.
- The person is economically dependent on the person/entity.
- The person is provided with tools of trade or work equipment by the other person.
- The person only works for or renders services to one person.

In addition to the statutory definitions in place, the civil courts in South Africa have developed several tests in order to establish whether an individual is an employee or not. These are the control test, the organisational test and the multiple or composite test. The Labour Appeal Court has accepted that the ‘dominant impression’ left by the contract in place and the actual working relationship are the final determinants of the legal nature and consequences of the relationship.

The control test focuses on the element of control exercised by an employer over the employee. The power to control has traditionally been regarded as the hallmark of the employment contract. But with the advent of highly skilled employees who are given a relatively free hand when performing their work, the courts no longer insist on de facto control, but recognise that a right to control is sufficient (*Rodrigues v. Alves & others* 1978 (4) SA 834 (A) at 842A).

The organisational test takes the control test further in the sense that it is based upon the assumption that the test of being under another's control does not rest on a submission to orders. It depends upon whether the person is part and parcel of the organisation. In other words, one looks at the extent to which a person/worker is integrated (made a part) into the organisation of the other person or whether the one person is performing work inside the organisation of another.

The dominant impression test requires that the entire picture should be looked at as a whole. While it is impossible to compile an exhaustive list of relevant factors, the most significant would be the Service Providers' right to select which of its personnel will do the work, the power of the Service Provider to terminate the relationship as opposed to the Intermediary, the personnel's obligation to work for a given time and for specified hours and whether remuneration is paid by the Service provider or the Intermediary for time worked or rather in relation to the end result of the work. Lastly, another factor is to determine which actor is responsible for providing the personnel with tools, equipment and office space.

Personnel of Service Providers earning less than ZAR193,805 per year would be at risk of being presumed to be an employee of the Intermediary if the provisions abovementioned are present. We would suggest that it is made clear at the outset that the personnel of Service Providers are under the final control of the Service Provider and not of the Intermediary. In addition, it would be prudent to always ensure that personnel of the Service Providers are remunerated directly by the Service Providers and not by the Intermediaries.



# MAURITIUS

## PART 1: INVESTORS

### 1 FUNDING AND PROCUREMENT

**1.1 Does the law of your jurisdiction allow donors in general (regardless of their legal nature [e.g., straight-out donors or social investors] to fund SIB schemes by directly delivering funds to an Intermediary (either as equity or loans)? Does the law prohibit or limit funding of social service programs? Would the law limit the structure in which the funding is made or the amounts to be funded? What legal formalities would apply to the delivery of funds to an Intermediary (e.g., notarial proceedings)?**

There is no specific legal provision in Mauritius that regulates SIB schemes or the parties involved in SIB schemes and/or their transactions.

A person may donate money to a non-profit organisation. As such, donors can contribute in two ways to such non-profit organisations. The ways are as follows:

- By way of gift
- Through the **CORPORATE SOCIAL RESPONSIBILITY ("CSR") PROGRAMME** in case of a corporate entity

#### CSR

CSR is the concept whereby companies act to balance their own economic growth with the sustainable social and environmental development of their areas of operation. The government of Mauritius has established a policy with the overall objective of mandating registered companies to pay 2 percent of their book profit toward programmes that contribute to the social and environmental development of the country.

A programme implemented by the company or a programme implemented under the National Empowerment Foundation or a non-governmental organization ("NGO") shall be an approved programme or an approved NGO.

Furthermore, delivering funds to an Intermediary is permitted in Mauritius regardless whether the funding is made by way of equity or loan. Any issuance of shares or debentures will be subject to the provisions of the **COMPANIES ACT 2001 ("COMPANIES ACT")**.

## 1.2 Given the legal framework under which the government is allowed to enter into agreements, what options, if any, would an investor have when contracting with the government directly?

Generally, in an SIB transaction, contracting with government can either be made through a competitive procurement process or a direct negotiation between an Intermediary and a government agency (the commissioner). Please refer to **section 2.3** below.

The enforceability of the contracts with the government will follow the same standards of ordinary contracts, although with an exception that one will not be able to enforce its rights even pursuant to a judgment against any property of the government.

Any negotiation between the parties will depend on the criteria set out in the tender process.

## 1.3 Are “hybrid investments” legal or subject to special regulation? Hybrid investments combine equity and debt structures, (i.e., a portion of loaned sums and a portion of direct investment). They could also combine debt and equity; for example, preferred stocks, convertible bonds.

A person may invest into a company by acquiring shares in the share equity capital of a company and, at the same time, invest in any form of debt securities such as convertible debentures. In that respect, there are no regulatory restraints.

## 1.4 What legal framework applies to debt and equity investments? What limitations or procedures apply to bringing in funds to the jurisdiction?

### EQUITY

Investment in a Mauritian company entails the issuance of shares to which voting and distribution rights are attached (unless otherwise provided for in its Constitution). Shares are issued for consideration generally determined by the board of directors.

The law that regulates the conduct of a company (including acquisition of shares in such a company) is the [MAURITIUS COMPANIES ACT 2001 \(COMPANIES ACT\)](#). Depending on the type of offering made to investors, other regulatory considerations may be relevant such as prospectus requirements.

Profits on shares may be distributed at the discretion of the board of directors of the company subject to satisfying the solvency test.

### DEBT

Investments by way of debt are generally structured by the issuance of debentures, bonds and notes by a company pursuant to Companies Act. The terms of the debentures (such as repayment, maturity and interest) are contractual.

Since exchange controls were repealed under the [FINANCE ACT 1994](#), no approval is required for either bringing in funds to Mauritius or for the repatriation of profits, dividends and capital gains earned by a foreign investor in Mauritius, however, money remitted

to regulated entities in Mauritius will be subject to provision of customer due diligence documentation pursuant to anti-money laundering laws.

**1.5 For equity investments, are there quantitative/qualitative legal limitations on the repatriation of profits (e.g., foreign exchange regulations)?**

There are no limitations on the repatriation of profits and no foreign exchange control regulations applicable in Mauritius at this time.

**1.6 Would the independent evaluator's report be binding to the government (i.e., assuming that the government is committed to accepting the outcome of the report, could the government challenge such a report)? What are the contract enforcement concerns and mechanisms to ensure that governments follow their commitment to pay according to an independent evaluator's report? Could the government easily challenge the report? What are the risks?**

An independent evaluator's report will be binding on the government if contractually agreed. As such, the best way to mitigate such risks is to ensure that appropriate safeguards are set out in the contract between the government and the Intermediary.

Eventually, the government does not enjoy immunity from suit. Hence, an action may be initiated and, likewise, a judgment may be obtained against the government. However, the judgment cannot be enforced against any property of the government.

## **2 TAX ASPECTS**

**2.1 What tax rules apply to the funding provided by investors (either donations, loans or equity)? Please consider both loans and equity contributions. Would withholdings apply to the repayment of capital/interest, or dividends/repatriation of equity?**

There is no tax applicable on funding provided by the investors irrespective of the form of the investments.

Dividend distributed by a domestic company is exempt from tax in Mauritius. With regard to withholding tax, there is no withholding tax on dividends paid by a Mauritian resident company whereas interest payable by any person (other than by a bank or nonbank deposit taking institution, under the [BANKING ACT OF MAURITIUS](#)) to any person, other than a company resident in Mauritius, is subject to 15 percent withholding tax.

**2.2 Does the Jurisdiction have international investment agreements, preferential trade or double taxation treaties in force? Are there any on the way of becoming effective (e.g., being negotiated, pending ratification, etc.)?**

Mauritius is a party to a number of Double Taxation Agreements (**DTAs**) and investment promotion and protection agreements (**IPPAs**).

As of today's date, Mauritius has 38 DTAs in force while some others are currently awaiting ratification/signature. The DTAs currently in force are with the following countries: Barbados, Belgium, Botswana, Croatia, Cyprus, Sri Lanka, France, Germany, India, Italy, Kuwait, Lesotho, Luxembourg, Madagascar, Malaysia, Monaco, Mozambique, Namibia, Nepal, Oman, Pakistan, Bangladesh, China, Rwanda, Senegal, Seychelles, Singapore, South Africa, Qatar, Swaziland, Sweden, Thailand, Tunisia, Uganda, United Arab Emirates, the United Kingdom, Zambia and Zimbabwe. The DTAs provide for the avoidance of double taxation and the taxation of certain income at a reduced rate.

In addition, Mauritius is party to 23 Investment Promotion and Protection Agreements ("IPPA") that are currently in force while 16 others are awaiting ratification (Benin, Cameroon, Comoros, Gabon, Ghana, Guinea Republic, Kenya, Kuwait, Mauritania, Nepal, Republic of Congo, Rwanda, Swaziland, Chad, Turkey and Zimbabwe). The IPPA provides for free repatriation of investment capital and returns and guarantee against expropriation.

The IPPAs currently in force are with the following countries: Barbados, Belgium-Luxembourg Economic Union, Burundi, China, Czech Republic, Finland, France, Germany, India, Indonesia, Madagascar, Mozambique, Pakistan, Portugal, Republic of Korea, Romania, Senegal, Singapore, South Africa, Sweden, Switzerland, Tanzania, the United Kingdom and Northern Ireland.

To our knowledge, there are certain cases in relation to the enforcement of Double Tax Avoidance Treaties and/or Investment Promotion and Protection Agreements. However, not many claims have been brought in that respect.

A brief summary of these cases is set out below:

1. **CASE NO.1:** *Indofood International Finance Ltd v. JPMorgan Chase Bank N.A, London Branch*<sup>1</sup>: an Indonesian resident company wished to borrow from third parties but would have faced a 20 percent withholding tax in Indonesia on interest payments if it had borrowed directly. It, therefore, set up a special purpose vehicle subsidiary resident in Mauritius that issued loan notes to the lenders and subsequently lent the proceeds to Indofood. This allowed access to a reduced withholding tax rate of 10 percent under the DTA between Mauritius and Indonesia.
2. **CASE NO.2:** *Re E\*Trade Mauritius Ltd [2010] (3) TMI 106 A.A.R. No.826 Of 2009*<sup>2</sup>: This refers to a sale of shares which was routed through a company based in Mauritius with which India had a Double Taxation Avoidance Agreement. The Indian income tax department held that since profit was generated in India, tax was liable to be paid there.
3. **CASE NO.3:** *Union of India v. Azadi Bachao Andolan*<sup>3</sup>: The Supreme Court of India validated the benefits of the Treaty for residents of Mauritius

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1 [2006] Ewca Civ 158 (Supreme Court Of Judicature, Court Of Appeal (Civil Division), London, United Kingdom)

2 Authority for advance rulings – Income Tax India

3 [2003] 263 ITR 706 (SC) (Supreme Court of India)

subject to having a valid tax residency certificate issued by the Mauritian government.

4. **CASE NO. 4: *Smallwood (and Related Appeal) v. Revenue and Customs Commissioners***<sup>4</sup>: The appellants sought to avoid capital gains tax on the sale of shares. The shares were held at a gain by a nonresident trust. The trust appointed a Mauritian trustee for a part of the tax year in question and realized the gains during the period that the trust was resident in Mauritius. UK-resident trustees were appointed before the end of the tax year. The appellants argued that the tax treaty between the UK and Mauritius prevented the UK from taxing the gains.

### **2.3 Are there tax incentives/breaks for socially oriented investing? How cumbersome is the process for obtaining/collecting these incentives?**

There are no specific tax incentives for socially oriented investment in Mauritius. However, the **SECOND SCHEDULE OF THE INCOME TAX ACT** provides for a list of 'exempt bodies of persons' including a charitable institution, a charitable foundation or a charitable trust. Companies and special purpose vehicles may finance approved NGOs for the implementation of any project which complies with **PART 2** of the CSR Guidelines.

It is also provided under the Income Tax Act that a company engaged in the provision of health services registered with the Board of Investment of Mauritius under the Investment Promotion Act may benefit from tax exemption for five years starting from the first year of operation.

### **2.4 Is it possible to write off losses or to reframe a failed investment in SIBs as a grant/donation? If so, would the grant/donation be subject to taxes?**

There are no provisions under Mauritius laws which enable the investors to reframe a failed investment as a grant or donation or any similar mechanism.

However, it would be possible to write off losses in accordance with Section 20 of the Income Tax Act if the donor is a Mauritian.

If the investor satisfies the director general of the Mauritius Revenue Authority ("**MRA**") that he has incurred a loss in an income year in the production of gross income as specified in certain sections of the Income Tax Act, that loss shall not be deducted from or set off against his gross income for that income year, but may be set off against his gross income (other than a gross income derived from a business) derived in that income year and any excess loss carried forward for set-off against income derived in the five succeeding income years.

When the director is not satisfied with a claim for loss made, the director general of the MRA shall determine the quantum of the loss available for set-off or carry forward and shall give notice of his determination to the person.

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4 [2008] SpC 669 (Court of Special Commissioners, United Kingdom)

## PART 2: GOVERNMENT

### **1 What is the general structure of the state in your jurisdiction? What degree of autonomy do government entities have for contracting?**

Mauritius has a centralised government structure. The president is the head of state while the prime minister has full executive power and is the head of government who is assisted by a council of ministers.

The government of Mauritius has the capacity and power to enter into contracts through the ministers of the relevant ministries or, in some instances, through public authorities empowered by law to that effect.

### **2 Do applicable public procurement rules authorize the implementation of an SIB scheme, i.e., funding social programs by means of an agreement between a government agency and an Intermediary, in which payment from the government would be entirely contingent on the organization achieving measurable and positive social outcomes?**

No. In the Budget Speech 2014, the minister of finance has announced that SIBs will be introduced, under the aegis of the Ministry of Social Integration and Economic Empowerment, for a rehabilitation programme of ex-convicts and drug addicts. However, no implementation measures or legislation have been put into place to that effect.

### **3 How does the government of the jurisdiction contract social services? Is public procurement subject to special rules or would it be subject to general and commercial law rules? Is there flexibility in the performance and supervision of contracts by government?**

There is no specific way for the government to contract social services. The general rules of public procurement will apply, i.e.:

- (i) open advertised bidding;
- (ii) restricted bidding;
- (iii) request for sealed quotations;
- (iv) direct procurement;
- (v) community or end-user participation;
- (vi) departmental execution;
- (vii) request for proposals; or
- (viii) direct procurement.

The contract can be direct with the Service Provider or through PPPs.

Generally, contracts are governed under the Mauritian Civil Code. The Public Procurement Act 2006 has laid down, in general terms, what the contract should contain.

The parties retain the flexibility to implement a reviewing mechanism that is acceptable to all parties to the contract.

Note, however, that an amendment to the contract that will increase the contract value by more than 25 percent shall require fresh procurement proceedings.

**4 May an Intermediary tender for both design and implementation stages or would there be impediments because of conflict of interests? Would it be possible to combine direct contracting or PPPs with public procurement and, thus, avoid the conflict of interests issue (i.e., Intermediary would either design or implement under a PPP or direct contract and, thus, be able to tender for the remaining stage.)?**

There is nothing in the [PUBLIC PROCUREMENT ACT](#) that restricts the Intermediary to tender for two different stages of a project. However, the request for proposal or the contract may provide otherwise.

**5 Does annual budgeting apply? If so, are there legal mechanisms to ensure future payments? Can these mechanisms commit future administrations? Where the law does not readily allow for future payments, could trust structures or special vehicles be set up to make up for any shortfalls in the law?**

The financial year of the government runs from the 1 January to 31 December. The annual budget will provide for a forecast income and expenditure for the next financial year. The annual budget will allocate to ministries sums that will then be assigned to specific projects. Once the government has completed the tender process and engaged contractually, it will be bound by its obligations to honour payments.

The use of special purpose vehicles ("SPVs") is feasible but is not common for government projects.

**6 What happens if a government entity does not execute the whole of its annual budget? Would there be any negative consequences for the entity? If so, would there be legal mechanisms to enable the "freezing" of budget funds?**

Please see above. Please note that the annual budget is a forecast of income and expenditure. There will be no negative consequences if the funds are not used for the purpose they were allocated for and if the government has not yet entered into an agreement with the entity.

## PART 3: INTERMEDIARY

### 1 If the Intermediary carries out activities as a mere advisor, would the law require the Intermediary to set up a permanent presence in the jurisdiction? If the Intermediary is receiving and administering investors' money, would the law require the Intermediary to set up a specific type of entity in the jurisdiction?

The need for the Intermediary to set up an establishment in Mauritius would depend on whether it is carrying on business in Mauritius. Much of this question involves determining the extent and importance of the actions performed by the Intermediary in Mauritius. If the Intermediary is regularly transacting with Mauritius customers and binding contracts are being executed in Mauritius, an inference could be made that the Intermediary is carrying out business in Mauritius and, consequently, it will need to register as a foreign company or a branch in Mauritius under the [COMPANIES ACT 2001](#).

Typically, the authorities have never made such a determination on any foreign company doing business in Mauritius without setting up a permanent establishment in the island, but it seems realistic that they would come to a determination that the foreign entity is conducting business in Mauritius if the campaign pursued takes a considerable dimension. It is a matter of degree and of nature of the activity.

In terms of provision of financial services, the regulator expects an applicant to have some permanent presence in Mauritius. The law does not impose a specific type of entity as such, but depending on the nature of the activities and to the extent that such activities are regulated, there are requirements for such an entity to be a body corporate. This is further detailed below.

### 2 What types of entities are available in the jurisdiction?

The use of a company as a vehicle tends to be the most preferred one, although *sociétés*, trusts and limited partnerships can also be used.

#### COMPANIES

- Companies are incorporated under the [COMPANIES ACT 2001](#) and may either be a private or a public company. A private company is limited to 25 shareholders and cannot offer shares to the public.
- A company is a legal person separate from its shareholders. The limited liability principle means that investors enjoy liability only up to the extent of their investment in the company and are not otherwise responsible for the debts and liabilities of a company.
- A company needs to be incorporated and is subject to statutory rules of filing and reporting that ensure transparency and accountability through their corporate formalities.
- Companies are not tax transparent. A company is one legal person and is treated as one taxing unit, and investors are not taxed in Mauritius at their level. The



distribution of income is subject to the company remaining solvent, which means that their assets must exceed their liabilities.

- A domestic company should have at least one director resident in Mauritius and one shareholder (foreign or local).
- The setting up of a company involves submission of prescribed forms (application forms, appointment of director and his consent to act, appointment of company secretary and his consent to act as such) to the Registrar of Companies, together with a Constitution (if the company chooses to adopt one) and reservation of name forms.

## BRANCH

- If a branch is set up and is conducting a licensable activity, the regulator will still expect the branch to comply with all the requirements in respect of the ongoing obligations, filing obligations and internal procedures to the same extent as the branch was a separate entity. These obligations would technically be the obligations of the main entity, as a branch does not constitute a separate legal entity. This may make it more onerous for the main entity and, therefore, that aspect must be weighed into the balance.
- The setting up of a branch requires the submission of the following documents to the Registrar of Companies:
  - i. A reservation of name form
  - ii. An authenticated copy of the certificate of its incorporation or registration in its place of incorporation or origin, or a document of similar effect
  - iii. A duly authenticated copy of its Constitution, charter, statute or memorandum and articles
  - iv. A list of its directors containing similar particulars with respect to directors as these are required by the Companies Act to be contained in the register of the directors, managers and secretaries of a company
  - v. If the list includes directors resident in Mauritius who are members of the local board of directors of the company, a memorandum duly executed by or on behalf of the foreign company stating the powers of the local directors
  - vi. A memorandum of appointment or power of attorney under the seal of the foreign company or executed on its behalf in such manner as to be binding on the company, stating the names and addresses of 2 or more persons resident in Mauritius, not including a foreign company, authorized to accept on its behalf service of process and any notices required to be served on the company
  - vii. A notice of the situation of its registered office in Mauritius and, unless the office is open and accessible to the public during ordinary business hours on each day, other than Saturdays and public holidays, the days and hours during which it is open and accessible to the public
  - viii. A declaration made by the authorized agents of the company

## TRUSTS

Trusts are created under the [TRUSTS ACT 2001](#). They can be created as a “purpose” or “beneficiaries” trust. Participants are issued with units in the trust. Trusts are easy to set up as the creation of a trust does not require any registration, incorporation or corporate filings. However, the lack of formality and reporting requirements make a trust less transparent than a company. Furthermore, trusts do not have corporate personality. A trust should appoint a qualified trustee (licensed by the Financial Services Commission) and trustees are subject to fiduciary duties. They tend to be less popular amongst investors due to unfamiliarity with its concepts.

## SOCIÉTÉS

*Sociétés* are set up under the provision of the [CIVIL CODE OR COMMERCIAL CODE](#). The participants’ interests are referred to as “*parts sociales*.” *Sociétés* are fiscally transparent and the liability of the “limited partners” can be limited. It is also possible to structure the *société* so that it is not liable to tax in Mauritius. The setbacks with *sociétés* are that they are based on a form of French partnership law, which has not evolved to accommodate modern structures, and French legal concepts and terminology may not be understood by all investors.

## LIMITED PARTNERSHIP

Limited Partnerships are governed under the Limited Partnership Act. A limited partnership can elect to have legal personality and is required to have at least one general partner (GP) who is liable for all the debts and obligations of the limited partnership and one limited partner (LP) who is liable only up to the maximum amount of its commitment. A limited partnership may elect to have a separate legal personality. Irrespective of whether a limited partnership has elected for legal personality or not, it retains its pass-through attribute such that the partners are liable for debts of the partnership (GP having unlimited liability whereas LPs are liable to the extent of their contribution or as they have agreed). Furthermore, limited partnerships are fiscally transparent and, in effect, a limited partnership will not be liable to tax (irrespective of whether or not it elects to have legal personality), but each partner will be liable to tax with its share of the income of the partnership.

The setting up of a limited partnership involves submitting to the Registrar of Limited Partnerships (which is the same as the Registrar of Companies) prescribed forms accompanied by the written consent of the general partners for the registration of the limited partnership given in a prescribed form and the partnership agreement containing prescribed particulars.

**3 Assuming that the Intermediary will receive funding (either through equity or loans) and will use them for the advancement of social projects, could the law of the jurisdiction consider that the Intermediary is carrying out financial intermediation activities or any other sort of regulated activity? What thresholds apply (if any) for being considered a regulated entity (i.e., under financial regulations)?**

Generally, financial intermediation services are regulated in Mauritius. The Financial Services Commission (the “FSC”) is the regulator for non-banking financial services sector.

The Intermediary cannot solicit another person to enter into securities transactions, unless it holds an investment adviser or investment dealer licence. This will be applicable to the extent the Intermediary markets, offers or solicits investor to invest in equity or bonds of any SPV constituted to collect funds and invest in social projects.

There are no specific applicable thresholds for a person to be considered into a regulated entity.

Generally:

- A person cannot, by way of business, advise, guide or recommend other persons, or hold himself out to advise, guide or recommend other persons, whether personally or through printed materials or by other means, to enter into securities transactions, or manage or hold himself out to manage, under a mandate, whether discretionary or not, a portfolio of securities, without an investment adviser licence.
- Furthermore, it should also be noted that a person requires an investment dealer licence if that person, by way of business, acts or holds himself out as an Intermediary in the execution of securities transactions on behalf of other persons; trades or holds himself out to trade in securities as principal for his own account with the intention of selling them to the public; or underwrites or distributes or holds himself out to underwrite or distribute securities on behalf of an issuer or a holder of securities. (No person other than a body corporate may apply for this licence.)

**4 Does the law of the jurisdiction set forth foreign exchange constraints or mechanisms for remitting money into the jurisdiction and converting it into local currency?**

There are no foreign exchange control (or any other such mechanism) applicable in Mauritius as of now.

**5 If the Intermediary requires bringing foreign personnel into the jurisdiction, please discuss briefly what types of visas/permits may be required.**

The foreign personnel must hold a valid work permit or occupation permit (as further particularized below) to be entitled to work in Mauritius.

Furthermore, if the Intermediary wishes to employ foreign personnel in bulk, it will be required to obtain the permission in principle of the Ministry (the “Permission in Principle”) prior to recruiting the foreign personnel.

Prior to seeking the Permission in Principle, the Intermediary will be required to:

- a) issue a press advertisement in two leading newspapers in A5 size specifying the number of workers required for each post; and
- b) obtain a report from the Employment Information Centre ("EIC"), whichever is nearer to the place of business of the Intermediary, confirming that a list of registered unemployed has been submitted to the Intermediary for consideration (the "Report").

## **6 Assuming that the Intermediary has been already set up as an entity in the jurisdiction, please discuss briefly what types of visas/permits would be required for it to engage overseas personnel for work in the jurisdiction.**

No noncitizen must engage in any occupation in Mauritius (for reward or profit) or be employed in Mauritius unless he/she holds a valid work permit or occupation permit. Exceptions apply to directors of a company, persons who visit Mauritius to inspect the plant, machinery or equipment of any factory or other industrial works, or to give technical advice on the operation of any local undertaking, business or enterprise of whatever kind, or persons who visit Mauritius, on behalf of a principal abroad, in connection with the appointing of, or for the purpose of having business consultations with, a local business agent or a local distributor. However, those exceptions are only valid for a period of 90 days in a calendar year.

The Intermediary would be required to obtain a Permission in Principle as mentioned above (to the extent that employment of foreign personnel is made in bulk) and, thereafter, apply for either a work permit (normally for workers) or an occupation permit (normally for professionals) for its overseas personnel.

### **WORK PERMIT**

Applications for work permits are made to the Employment Division of the Ministry of Labour, Industrial Relations and Employment that issues the work permits under the **NONCITIZENS (EMPLOYMENT RESTRICTION) ACT 1973**.

To be entitled for a work permit, the foreign workers must be employed to do a specific job on a full time basis.

### **Criteria for applications**

There are certain criteria to be met for a foreign worker to obtain a work permit. The criteria are as follows:

- a) The worker must possess the skills, qualifications and experience required for the job applied for.
- b) The worker must be aged between 20 and 60 years old, although departure from this policy is exceptionally made for investors and expatriates who are above 60 years old and who possess specific expertise.
- c) The worker must not hold a Tourist Visa.

The Intermediary must provide the expatriate with an air ticket to return to his/her home country on the termination of the contract of employment or for any cause whatsoever.

#### Duration of work permits

Normally, a work permit in respect of foreign skilled workers is granted for a maximum period of four years.

Expatriates employed specifically at managerial/supervisory/technical levels may be allowed to work for a period of five years or more, subject to full justifications being provided and upon their swearing of an affidavit to the effect that they will not apply for Mauritian citizenship. They will also be required to furnish an additional bank guarantee of MUR20,000 to the Passport & Immigration Office as from their fifth year of employment.

#### OCCUPATION PERMIT

In the event the Intermediary intends to employ foreign professionals meeting the criteria below, the Intermediary can make an application for occupation permit in respect of the foreign professionals, as an alternative to the work and residence permit route mentioned above.

An occupation permit is a combined work and residence permit that allows a foreign professional meeting the criteria to reside and work in Mauritius.

#### Criteria to be met

A foreign professional must meet certain criteria in order to make an application for occupation permit. The criteria are as follows:

- a) The foreign professional must be employed by a company incorporated in Mauritius to deliver professional services.
- b) The foreign professional must earn a monthly basic salary exceeding MUR45,000 (MUR 30,000 in the case of professionals in the ICT sector) to make an application under this category.
- c) The foreign professional must arrive in Mauritius with a Business Visa which is valid for at least fifteen days (a request of the same should be made upon arrival into the country).

#### Duration

An occupation permit is issued for the period specified in the contract of employment of the foreign professional or for a period of three years, whichever is lesser.

#### Application

An application for occupation permit must be submitted to the Board of Investment (the “BOI”).

The foreign professional must be physically present in Mauritius and must call in person at the Occupation Permit Unit of the BOI. The foreign professional must be accompanied by the Human Resource Manager or a representative of the Intermediary.

Upon approval, the foreign professional is registered with the BOI and the Passport and Immigration office (“**PIO**”) issues the occupation permit.

An occupation permit is generally issued within five working days. The applicant should personally collect the occupation permit at the PIO Delivery Section.

## **7 Is there any requirement for Intermediary’s directors/officers in the Jurisdiction to be national or residents of the Jurisdiction?**

In terms of a company incorporated in Mauritius, the Mauritius Companies Act 2001 requires that at least one director of a domestic company must be ordinarily resident in Mauritius.

A Mauritian trust should appoint one qualified trustee licensed by the FSC.

A limited partnership needs to have a registered agent in Mauritius, unless the general partner (or at least one general partner) is domiciled in Mauritius.

## **PART 4: SERVICES PROVIDERS**

### **1 Assuming that the Intermediary signs a contract with the government, would the law allow the Intermediary to freely choose and contract with the service provider? Would the contract with the government restrict the choice of service provider made by the Intermediary?**

It will be mainly a contractual matter, but subject to any applicable request for proposal requirements, following which, the choice of the Service Provider could be restricted.

### **2 Is there a substantial risk that services providers’ personnel could be re-characterized as employees of the Intermediary? What mechanisms are available for reducing/managing this risk?**

The parties should ensure that elements required for an employment relationship are not present in dealing with personnel of the Service Provider, for instance, entitlement to basic salary and elements of control and subordination. Furthermore, in the contract between the Intermediary and the Service Provider, a clause could be inserted to the effect that the personnel of the Service Provider shall, at no time, be considered as employees/agents of the Intermediary.

## PART 1: INVESTORS

### 1 FUNDING AND PROCUREMENT

- 1.1 Does the law of your jurisdiction allow donors in general (regardless of their legal nature [e.g., straight-out donors or social investors] to fund SIB schemes by directly delivering funds to an Intermediary (either as equity or loans)? Does the law prohibit or limit funding of social service programs? Would the law limit the structure in which the funding is made or the amounts to be funded? What legal formalities would apply to the delivery of funds to an Intermediary (e.g., notarial proceedings)?**

#### DONATIONS TO OR INVESTMENTS BY NONRESIDENTS IN SOCIAL SERVICE PROGRAMMES

In India, investment by nonresidents into the social services sector ("[Social Impact Investment](#)") can be made in three main forms:

- a) **DONATIONS** – Such grants or donations may be made by offshore or Indian resident sources. This could include:
  - i. **FOREIGN CONTRIBUTIONS** – These are grants and donations by nonresidents ("[Foreign Contributions](#)") that would be governed by the [FOREIGN EXCHANGE MANAGEMENT ACT, 1999](#) ("[FEMA](#)") and the regulations issued thereunder and the provisions of the [FOREIGN CONTRIBUTION \(REGULATION\) ACT, 2010](#) ("[FCRA](#)"). Donations or grants from domestic sources may be from individuals, trusts or corporations.
  - ii. **CONTRIBUTIONS AS CSR** – In case the Intermediary entity has been set up as a company, the investors may also choose to contribute capital in the form of projects coordinated with such company under the [CORPORATE SOCIAL RESPONSIBILITY \("CSR"\) PROGRAMME](#) mandated under the Companies Act, 2013. Contribution to CSR may be structured in various forms and has been discussed in this memorandum of our responses ("[Memorandum](#)") subsequently.
  - iii. **EQUITY INVESTMENTS** – The investors can infuse capital in consideration for equity holding in the Intermediary entity, in case the Intermediary has been set up as a "[Social Venture Fund](#)". A Social Venture Fund is an Alternative Investment Fund ("[AIF](#)") which invests primarily in securities or units of social ventures and which satisfies social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns.

- b) **DEBT** – Overseas entities may also choose to provide loans to the Intermediary in the form of External Commercial Borrowings (“**ECBs**”).

In the Annexures A, B and C to this Memorandum, we have set out the restrictions, procedural formalities and conditionalities for the first two routes mentioned above, i.e., for Foreign Contributions, Social Venture Funds, and for CSR programmes, respectively. Furthermore, in Annexure E to this Memorandum, we have set out some of the basic principles governing ECBs in India.

## 1.2 **Given the legal framework under which the government is allowed to enter into agreements, what options, if any, would an investor have when contracting with the government directly?**

### CONTRACTS WITH THE GOVERNMENT OF INDIA

An investor can contract with the government of India in three modes:

#### a) **BY THE PROCESS OF COMPETITIVE BIDDING**

This involves a well-publicized and a well-designed bid process to ascertain financial, technical and managerial capabilities of the Service Provider or the developer. The bidding may be by single round auction, or multiple round outcry. The appropriate bidding process depends on the valuation of the project under consideration. This is the most preferred approach of the government, as rules framed by the Central Vigilance Commission of India (“**CVC**”) require that due to the need for greater transparency in public works, the award of any contract by any government agency in India should take place by means of a tendering process or public auction only. In such competitive bidding, it is the lowest bidder that gets finalised as the party to contract with the relevant arm of the government.

#### b) **BY THE PROCESS OF COMPETITIVE NEGOTIATION**

Competitive negotiation (direct or indirect) is a variant of competitive bidding. The government specifies the service objective and invites proposals through advertisements. The government then negotiates/finalizes the contract with the selected bidders. Competitive negotiation is opted usually for social sector projects involving: (a) voluntary organizations, NGOs and the local community; (b) technology-related or linkage/ancillary projects; (c) projects in which competitive bidding process has failed; and (d) upon suo motu proposal from a private participant.

#### c) **BY SWISS CHALLENGE/UNSOLICITED BID APPROACH**

The Swiss Challenge approach refers to suo motu proposals being received by the government from the private participant. The private party must provide in advance all details regarding: (a) its technical, financial and managerial capabilities; (b) technical, financial and commercial viability of the project/programme; and (c) expectation of government support/concessions. In the event of a better proposal being received by the government, the original proponent is given the opportunity to modify the original proposal. Finally, the better of two versions is awarded the project/programme for execution.



Unsolicited bids/Swiss Challenge proposals of private contractors are usually not preferred by the government. The discomfort with the use of unsolicited proposals in the public sector is due to its lack of transparency, and lack of fair and equal treatment of potential bidders due to informational and bidding asymmetries of data, time and prices between an original proponent and its competitors. Thus, this kind of model is allowed only in exceptional circumstances particularly in sectors not traditionally associated with PPP structures or when procurement of proprietary technology is involved. Variants of the approach could also be considered for development, with prior approval of the competent authority, provided the Value-for-Money ("VfM") analysis establishes such a decision on the part of the government.

The type of government contract which comes closest to the Instiglio model envisaged in this memorandum is the Public Private Partnership (PPP) model in India. The key features of such PPP projects have been discussed in more detail in Annexure D hereto.

#### ENFORCEABILITY AND NEGOTIABILITY OF CONTRACTS WITH THE GOVERNMENT OF INDIA

**ARTICLE 299 OF THE CONSTITUTION OF INDIA** authorizes the state to enter into contracts with private parties ("Government Contracts"). It has been held by courts in India that no distinction can be made between private party contracts and government contracts, in so far as the interpretation of the contract is concerned (*Ram Lal v. State of Punjab* AIR 1966 Punj 436). Neither the **INDIAN CONTRACT ACT, 1872** ("**CONTRACT ACT**") nor the **INDIAN PARTNERSHIP ACT, 1932** ("**PARTNERSHIP ACT**") treats the government on any special footing for purposes of formation or enforceability of the contract (*State of UP v. Raja Ram*, AIR 1966 Cal 159). The function of the government in respect of which the contract is entered into would also not make any difference, be such function sovereign or non-sovereign, governmental or commercial. Subject to the formalities prescribed by **ARTICLE 299**, the contractual liability of the state is the same as that of a private individual under the Contract Act. We have set out the specific requirements for Government Contracts under Article 299 in **Section 2.1** below.

Having said that, it should be noted that more often than not, Government Contracts are of standardized or pre-set form that have to be accepted in totality or not at all. As this may lead to unequal bargaining position between the private contractor and the government, Government Contracts are often subject to the scrutiny of courts. The result of such special forms of 'loaded' contracts is that the government gains a degree of control over the private contractor, i.e., certain special privileges are accorded to the government whether in the form of special treatment under the statute of limitations, or the ability to impose penalties without preliminary recourse to the courts. This is justified because of the special purpose for which government agencies are established, i.e., the service of the community.

The judiciary in India, too, has been candid in maintaining that judicial review cannot always extend to policy matters which are the prerogative of the government. The courts have generally restrained themselves from interfering in matters relating to

bidding and award of projects unless the arbitrariness and illegality is apparent on the face of it. For these reasons, dispute resolution under Government Contracts is usually by way of alternative dispute resolution (not court-driven litigation) – including amicable settlement, conciliation, mediation, arbitration and expert adjudication.

It should also be noted that by a further notification dated 3 March 2007, the Central Vigilance Commission (“CVC”) has banned post-tender negotiations (including counteroffers) with L-1, i.e., the lowest bidder, except in exceptional situations. With respect to the exceptional situations, convincing reasons must be recorded by the authority recommending negotiations. Competent authority should exercise due diligence while accepting a tender or ordering negotiations or calling for a re-tender and a definite time frame should be indicated so that the time taken for according requisite approvals for the entire process of award of tenders does not exceed one month from the date of submission of recommendations. In cases where the proposal is to be approved at higher levels, a maximum of 15 days should be assigned for clearance at each level. In no case should the overall time frame exceed the validity period of the tender and it should be ensured that tenders are invariably finalised within their validity period.

#### SCOPE FOR POSSIBLE RE-NEGOTIABILITY OF CONTRACTS DURING THE TERM OF THE CONTRACT

As discussed above, the Government Contracts are usually of preagreed and standardised form, whether by way of competitive bidding, competitive negotiation or Swiss Challenge proposal. There is little scope for possible re-negotiations of the Government Contract between the parties, or at the most, will depend on the terms of the original Government Contract.

On the other hand, when the state enters into a nonstatutory contract, the rights of the parties inter se will be governed by the terms of the contract. It is treated as a bilateral contract not involving the exercise of any sovereign power by the state. The key requirement is consensus ad idem for any contract to be entered into or renegotiated irrespective of whether it is an ordinary contract or a Government Contract.

### **1.3 Are “hybrid investments” legal or subject to special regulation? Hybrid investments combine equity and debt structures, (i.e., a portion of loaned sums and a portion of direct investment). They could also combine debt and equity; for example, preferred stocks, convertible bonds.**

#### LEGAL RESTRICTIONS ON HYBRID (I.E., DEBT + EQUITY) INVESTMENTS IN INDIA

Hybrid investments into Indian companies have been permitted in India. Hybrid investments can be brought into the company through a combination of issuance or transfer of equity shares (including gift, sale under private arrangement, sale on the stock exchange), convertible preference shares, and/or convertible debentures, etc.

The terms of each of these instruments are diverse and are regulated by separate laws promulgated by the Reserve Bank of India ("RBI") and/or the Securities and Exchange Board of India ("SEBI").

Hybrid investments can be made by both domestic and foreign investors. Hybrid investments by domestic investors are fully permitted, subject to the requirements of laws framed by SEBI from time to time. On the other hand, India being an exchange-controlled jurisdiction, hybrid investments by foreign investors need to also conform to the FEMA, and the rules and notifications framed thereunder by the RBI from time to time regulate the issue and transfer of such hybrid investments.

In the case of any convertible capital instruments, i.e., the fully, compulsorily and mandatorily convertible debentures or preference shares, the price/conversion formula of the convertible capital instruments is required to be determined upfront at the time of the issuance of the capital instruments and the price at the time of conversion of the capital instruments should not, in any case, be lower than the fair value worked out, at the time of the issuance of such instruments, in accordance with the extant regulations. Please note that in terms of the said regulations of RBI framed under the FEMA framework, however, there are certain sectors in which foreign investment is not permitted under the automatic route and requires specific approval, such as, the domestic airlines, broadcasting, print and news media, atomic minerals, defense, etc. Debentures and preference shares (which are not fully and compulsorily convertible into equity shares), are subject to the provisions of the regulations pertaining to ECBs, as set out in Annexure E in more detail.

## **1.4 What legal framework applies to debt and equity investments? What limitations or procedures apply to bringing in funds to the jurisdiction?**

### **CHANNELIZATION OF DEBT AND/OR EQUITY FUNDS FROM FOREIGN JURISDICTIONS INTO INDIA, AND TREATMENT OF PROFITS THEREFROM**

India is an exchange-controlled jurisdiction and all investments by foreign investors or all transactions between a resident and a nonresident are governed by FEMA and the rules and regulations framed thereunder by RBI from time to time. The investment routes available for equity investments into India include the following:

#### **A. THE FOREIGN DIRECT INVESTMENT ("FDI") ROUTE**

Under the provisions of **FOREIGN EXCHANGE MANAGEMENT** (Transfer or Issue of Security by a Person Resident outside India) **REGULATIONS, 2000 ("FEMA 20")** and **CONSOLIDATED FOREIGN DIRECT INVESTMENT POLICY** dated 5 April 2013, ("**FDI POLICY**"), a foreign investor is permitted to subscribe directly to or directly acquire equity shares, fully and mandatorily convertible preference shares (converting into equity within a fixed period of time, with formula for such conversion being set out upfront) and fully and mandatorily convertible debentures (converting into equity within a fixed period of time, with formula for such conversion being set out upfront) of an Indian company through the FDI route, subject to certain conditions.

Such conditions inter alia include that: (i) the level of foreign investment must be within the sector specific caps prescribed under the FDI Policy and FEMA; (ii) the price at which the securities are subscribed to or purchased is required to be in accordance with the provisions of the FDI Policy; and (iii) certain filings are required to be made with the RBI subsequent to the investment.

#### B. THE FOREIGN PORTFOLIO INVESTMENT ("FPI") ROUTE

Portfolio investors registered in accordance with the [SECURITIES AND EXCHANGE BOARD OF INDIA \(FOREIGN PORTFOLIO INVESTORS\) REGULATIONS, 2014 \('FPI REGULATIONS'\)](#), namely, Foreign Institutional Investors ('FIIs') and Qualified Foreign Investors ('QFIs'), may purchase and sell shares and convertible debentures of Indian companies through registered stock brokers on recognized stock exchanges in India as well as purchase shares and convertible debentures through public offer/private placement, subject to the conditions provided under FEMA 20 (some of which have been mentioned above in paragraph (A)).

#### C. THE FOREIGN VENTURE CAPITAL INVESTMENT ("FVCI") ROUTE

The investments/divestments under the FVCI route are governed by the [SEBI \(FOREIGN VENTURE CAPITAL\) REGULATIONS, 2000 \("FVCI REGULATIONS"\)](#). The FVCI regime was introduced in 2000 for foreign private equity/venture capital investors. Registration with SEBI is mandatory for investment under the FVCI route. Once registered with SEBI as an FVCI, entities can make investment in Indian venture capital undertakings or in Indian venture capital funds.

RBI has been permitting FVCIs to invest in nine approved sectors namely: (i) nanotechnology; (ii) information technology relating to hardware and software development; (iii) seed research and development; (iv) biotechnology; (v) research and development of new chemical entities in the pharmaceutical sector; (vi) production of biofuels; (vii) building and operating composite hotel-cum-convention centre with seating capacity of more than three thousand; or (viii) developing or operating and maintaining or developing, operating and maintaining any infrastructure facility as defined in the explanation to [CLAUSE \(I\) OF SUB-SECTION \(4\) OF SECTION 80-IA OF THE IT ACT](#); or (ix) dairy or poultry industry. FVCIs cannot invest in non-banking financial services (except certain non-banking finance companies registered with RBI), gold financing and other activities that are not permitted under the FDI regime.

#### D. INDIRECT INVESTMENTS IN THE INDIAN COMPANY

Indirect investments may be made into Indian companies by the foreign investors by acquiring securities of an offshore company which in turn holds securities of the Indian company. However, such an indirect acquisition may trigger the requirement to obtain regulatory approvals in India depending on the sector in which the Indian company is operating and the extent of acquisition (i.e., in certain cases additional approvals may be required where the transaction results in an indirect change in control of the Indian company).

## E. INVESTMENT BY SUBSCRIBING TO DEPOSITORY RECEIPTS OR BONDS ISSUED BY INDIAN COMPANIES

Foreign investors are also permitted to subscribe to American Depository Receipts (“ADRs”), Global Depository Receipts (“GDRs”) and Foreign Currency Convertible Bonds (“FCCBs”) issued by Indian companies in accordance with the Scheme for issue of the Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, (“1993 Scheme”) and circulars and guidelines issued by the government of India and directions issued by RBI from time to time in this regard. The pricing of ADR/GDR issues is required to be made at a price determined under the provisions of the 1993 Scheme and guidelines issued by RBI from time to time. The ECB Guidelines set out in Annexure E to this Memorandum are also applicable to the issue of FCCBs by Indian companies.

Furthermore, it must be noted that in 2008, the government of India introduced a new scheme governing the issue of foreign currency exchangeable bonds (“FCEBs”) known as the Issue of Foreign Currency Exchangeable Bonds Scheme, 2008, (“FCEB Scheme”). Under the FCEB Scheme, an Indian company can issue FCEBs to a person residing outside India in foreign currency. The major difference between FCCBs and FCEBs is that while FCCBs can be converted into the equity of the Indian company that is issuing the FCCB, an FCEB can be converted into the equity of a group company (“Offered Company”). The issue of FCEBs is subject to certain conditions such as the issuing company being part of the promoter group of the Offered Company and the proceeds of FCEBs being subject to end-use restrictions prescribed under the CB Guidelines, etc.

Please also refer to our response in **Part 1, Section 1.3** above and **Section 1.5** below for more information. Detailed analysis of the procedures and requirements for the debt and/or equity investments, and the treatment of profits therefrom, may be possible only on a case-to-case basis.

### 1.5 For equity investments, are there quantitative/qualitative legal limitations on the repatriation of profits (e.g., foreign exchange regulations)?

#### LEGAL RESTRICTIONS ON REPATRIATION OF PROFITS FROM EQUITY-BASED FOREIGN INVESTMENTS

Foreign capital in India is generally permitted to be repatriated along with capital appreciation, if any, after the payment of taxes due on them, provided the investment was made on a “repatriable basis” in terms of the FEMA and the rules and regulations framed thereunder.

Generally, remittance or credit of net sale/maturity proceeds (after payment of taxes) from sale of securities (such as shares, debentures, dated government securities, treasury bills, etc.) is permitted to be made to or by the foreign investors. Remittance is usually also permitted to be made with respect to dividend, interest payable,

or approved income to the share/debenture/government securities holder at the applicable rate, subject to deduction of tax at source.

Depending on the route or mode of investment into India, remittance of various kinds of funds is permitted into India, including winding-up proceeds of companies, reimbursements for preoperating expenses, royalty, lump sum fees for technical services, consultancy fees and dividends.

Separate permission of the RBI is not required to carry out such remittances, subject to compliance with certain specified conditions under the FEMA framework, if any. For example, different limitations may have been prescribed for specific sectors for repatriation of profits. In addition, sundry remittances are allowed for certain items, including gifts, repair charges for imported machinery, maintenance and legal expenses, subject to prescribed limits.

**1.6 Would the independent evaluator's report be binding to the government (i.e., assuming that the government is committed to accepting the outcome of the report, could the government challenge such a report)? What are the contract enforcement concerns and mechanisms to ensure that governments follow their commitment to pay according to an independent evaluator's report? Could the government easily challenge the report? What are the risks?**

**EFFECT AND ENFORCEABILITY OF THE INDEPENDENT EVALUATOR'S REPORT**

The Instiglio model envisages the appointment of an independent evaluator who would monitor and evaluate the performance of the terms of the Government Contract.

Indian public procurement laws prescribe that monitoring of Government Contracts may be done in either of the four following ways: (i) by government departments authorized to do so, based on a standardized scale; (ii) by independent agencies/regulators, based on a standardized scale; (iii) by the government department or independent agencies, based on the simple criteria of 'pass' and 'fail'; or (iv) by the government department or independent agencies, based on the feedback received from the beneficiaries.

Involvement of third party/independent agencies for monitoring has been preferred as this leaves the government hassle-free over the project and at the same time minimizes the need for government control. In such cases, a certain percentage of the cost of the project is, therefore, earmarked for contract management. Option is available for the government and the private party to mutually decide on the third party evaluator. The third party involvement could be further supplemented with provision for adjudication by the (higher) judiciary.

The government has, over time, shortlisted a panel of third party transaction advisers, from among whom the final third party evaluator may be selected by a process of competitive bidding or competitive negotiation. A Swiss Challenge proposal (as

described in **Section 1.2** above) may also be made for the ultimate selection of the independent evaluator.

Enforceability of the independent evaluator's report would depend on the terms of the Government Contract and the contract appointing such evaluator – for example, whether the report would be binding or merely recommendatory. Provision could also be included to appeal such report to a higher authority, as discussed above.

It should additionally be noted that the rules framed by CVC from time to time prescribe the formulation of an "Integrity Pact," a vigilance tool first promoted by the Transparency International, which is a preliminary agreement between the prospective bidders and the relevant government entity, committing the representatives of both the parties not to exercise any corrupt influence on any aspect of the Government Contract to be signed. Only those vendors/bidders who have entered into such an Integrity Pact with the government entity would be competent to participate in the actual bidding process, i.e., entering into the Integrity Pact would be a preliminary qualification, and it would be effective from the stage of invitation of bids up to the complete execution of the Government Contract. The Integrity Pact requires that an independent external monitor (IEM) be appointed by the government to monitor independently and externally whether both parties are complying with the terms of the Integrity Pact. Such an IEM has to be fair and impartial; has the right to access of information from both parties; and has to submit a written report on the basis of his investigations within 8–10 weeks from the date of reference of the matter to him.

## 2 TAX ASPECTS

### 2.1 What tax rules apply to the funding provided by investors (either donations, loans or equity)? Please consider both loans and equity contributions. Would withholdings apply to the repayment of capital/interest, or dividends/repatriation of equity?

We are not tax advisers and do not provide legal advice in relation to taxation aspects of Foreign Contributions, Social Venture Funds, Government Contracts, CSR programmes or otherwise. However, the following points in relation to your queries in this section of the memorandum may be of relevance:

- (i) Under section 80G of the Indian Income-tax Act, 1961, the amount of donation is deductible from taxable income, either in full or to the extent of at least half the amount. The aggregate maximum amount, allowed as a deduction, is usually subject to a ceiling percentage of the gross total income of the donor.
- (ii) India is party to several Double Taxation Avoidance Treaties/Agreements ("DTATs/DTAAs"), such as those with Mauritius, Singapore, and USA, under which taxation exemptions/benefits and norms for withholding taxes have been prescribed for various kinds of investments into India.
- (iii) Rules for taxation of CSR programmes of Indian companies have not yet been notified.



**2.2 Does the Jurisdiction have international investment agreements, preferential trade or double taxation treaties in force? Are there any on the way of becoming effective (e.g., being negotiated, pending ratification, etc.)?**

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**2.3 Are there tax incentives/breaks for socially oriented investing? How cumbersome is the process for obtaining/collecting these incentives?**

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**2.4 Is it possible to write off losses or to reframe a failed investment in SIBs as a grant/donation? If so, would the grant/donation be subject to taxes?**

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## PART 2: GOVERNMENT

**1 What is the general structure of the state in your jurisdiction? What degree of autonomy do government entities have for contracting?**

### STRUCTURE OF THE STATE

India is a federal constitutional republic governed under a parliamentary system, comprising of 28 states and seven union territories. There is separation of powers among the three organs of state – whether at the central level or at the state level – the executive, the legislature and the judiciary. At the central level, the president is the head of state, while at the state level, the governor is the head of the state.

All states as well as the union territories have elected bicameral legislatures and executive arms. The central government, i.e., the executive arm at the central level, is headed by the prime minister. The state government, i.e., the executive arm at the state level, is headed by the chief minister.

India has a unitary independent three-tier judiciary, with the Supreme Court at the apex, the state-wise 24 High Courts and a large number of district-level trial courts.

### AUTONOMY TO CONTRACT AND SCOPE OF CONTRACTING POWER OF STATE

As discussed above in **Part 1, Section 1.2**, the government (through its government agencies, various public sector undertakings, etc.) has the power to contract with third parties. This power is available for both the state governments and the central government. However, one restriction on such contracting power is the restriction in relation to legislative fields, as stipulated under Schedule VII of the Constitution of India. The Seventh Schedule of the Constitution of India demarcates the spheres over which



the central government and/or the state government(s) can legislate. The Schedule VII is divided into three Lists:

- **LIST I (UNION LIST)** refers to the legislative areas over which only the central government or the parliament (i.e., the central legislative body) may legislate.
- **LIST II (STATE LIST)** refers to the legislative areas over which only the state government or the State Legislative Assembly (i.e., the legislative body at the state level) may legislate.
- **LIST III (CONCURRENT LIST)** refers to the legislative areas over which the central government/parliament or the state government/State Legislative Assembly may legislate.

However, for any Government Contract to be enforceable, it must meet the following requirements of **ARTICLE 299 OF THE CONSTITUTION OF INDIA**:

- (i) It must be expressed to have been made by and executed on behalf of the president (at the central level) or the governor (at the state level).
- (ii) Its execution must be by such person (“government officer”) and in such manner as the president or the governor may direct.
- (iii) Authorization of the government officer may be by ad hoc means or a publication in the official gazette.
- (iv) It should preferably be a written contract. It cannot be an oral contract, but a mere tender and its acceptance, or even correspondence, is sufficient to form the Government Contract.

If the grounds of Article 299 are not met, neither party would be able to enforce the contract. The contract would be considered null and void.

## **2 Do applicable public procurement rules authorize the implementation of an SIB scheme, i.e., funding social programs by means of an agreement between a government agency and an Intermediary, in which payment from the government would be entirely contingent on the organization achieving measurable and positive social outcomes?**

### **PAYMENTS CONTINGENT ON PERFORMANCE**

Execution of contingent contracts is allowed under the Contract Act. Many of the PPP models, more particularly described under Annexure D hereto, adopted the strategy of linking payments to performance. (For example, please refer to Performance Based Management/Maintenance contracts discussed in Annexure D.) Alternatively, a Social Venture Fund may accept muted returns for its investors, say, in situations of lower performance levels, as discussed in Annexure B hereto.

### 3 **How does the government of the jurisdiction contract social services? Is public procurement subject to special rules or would it be subject to general and commercial law rules? Is there flexibility in the performance and supervision of contracts by government?**

#### MECHANISM OF NEGOTIATING, ENTERING INTO, REGULATION, PERFORMANCE AND SUPERVISION OF CONTRACTS WITH GOVERNMENT

Please refer to **Part 1, Sections 1.2** and **2.1** hereto on the method and mechanism for the negotiation, execution, regulation, performance and supervision of Government Contracts. The terms of these Government Contracts will depend on the terms of the contract and the relevant bidding requirements. We have set out the key features of PPP projects, which are closely aligned to the Instiglio model, in Annexure D hereto.

Please note that there is a tremendous variation with respect to such governance of tenders and PPP projects across states, government departments and industrial/social sectors. It would be difficult to list out these requirements and procedural formalities specifically. For example, in the state of Andhra Pradesh, the Andhra Pradesh Infrastructure Development Enabling Act, 2001 has been enacted to facilitate greater private sector participation in infrastructure projects, whereas in Orissa, the Orissa PPP Policy, 2007 serves as guidance for PPP projects. Recently, the government has issued the Draft National PPP Policy, 2011. However, this is still a white paper for discussions and has not yet been passed.

Furthermore, please note that the government of India has also recently drafted the Public Procurement Bill, 2012 ("PP Bill") governing public procurement by all the Indian government's ministries, departments and offices, where the estimated cost is above INR0.5 million. Each bidder is required to establish and conform to a code of integrity according to the provisions of the PP Bill and the PP Bill also envisages a mechanism under which any bidder aggrieved may seek redressal of its grievances. The PP Bill proposes the establishment of a Central Public Procurement Portal which will be accessible to the public for posting notices with respect to public procurement, stipulating the contents of the bidding documents, laying down of mechanism for seeking pre-bid clarifications and setting out of penalties for noncompliance (including corruption and other criminal offences). However, as of now, the PP Bill has not been passed into legislation.

**4 May an Intermediary tender for both design and implementation stages or would there be impediments because of conflict of interests? Would it be possible to combine direct contracting or PPPs with public procurement and, thus, avoid the conflict of interests issue (i.e., Intermediary would either design or implement under a PPP or direct contract and, thus, be able to tender for the remaining stage)?**

**AVOIDING CONFLICTS OF INTEREST BETWEEN DESIGN AND IMPLEMENTATION STAGES**

A major rule for all Government Contract formulation is the avoidance of conflicts of interest in order to prevent collusion and cartelization. The notifications issued by CVC from time to time prescribe that if any agent, broker, Intermediary or company is bidding for the same project – and by implied construction, bidding for more than one stage of the same project – then the Intermediary or other person must disclose all its interest upfront to the government. The CVC has specifically noted at one point that: “Collusion among the contractors was observed where more than one contractor(s) [were] involved at various stages.” For this reason, the CVC has prescribed mandatory disclosures by the private parties as part of the bidding process, which would be audited by the relevant vigilance team. The Intermediary must ensure the upfront disclosure of its interest in each relevant stage of the bidding/negotiation for the Government Contract.

The CVC also permits the formation of “consortiums,” where two or more bidders collaborate and combine their individual strengths such that their bid or proposal gets pre-qualified by the government agency, provided adequate disclosure has been made with respect to the same. The consortium thus formed often forms a special company or a “special purpose vehicle” (SPV) and the SPV then signs a contract with the government and with the subcontractors to build the facility and maintain it.

The above requirements are usually also included in the Integrity Pact (as discussed earlier in **Part 1, Section 1.6**) to be entered into before the commencement of any bidding process. The Integrity Pact requires that all prospective bidders must disclose any payments made or committed to be made to any agents, brokers or other Intermediaries in connection with the award of the Government Contract. The prospective bidder would also have to enter into a commitment contract with all its subcontractors, stating that such subcontractors would also be bound by the terms of the Integrity Pact. The terms “agent,” “representative,” “broker,” “subcontractor,” and “Intermediary” have not been defined by the CVC. However, it is our understanding that as long as the due disclosures have been made and the necessary agreements have been entered into, we do not see any prohibition against the engagement of Intermediaries (i.e., Service Providers) by the prospective bidder (i.e., the Intermediary).

**5 Does annual budgeting apply? If so, are there legal mechanisms to ensure future payments? Can these mechanisms commit future administrations? Where the law does not readily allow for future payments, could trust structures or special vehicles be set up to make up for any shortfalls in the law?**

**MECHANISMS FOR ENSURING PAYMENTS FROM PRESENT AND FUTURE FORMS OF GOVERNMENT/PROTECTION AGAINST ANNUAL BUDGETING RESTRICTIONS**

Payment by the government to the private sector could take the form of: (a) contractual payments; (b) grants-in-aid; and (c) right to levy user charges for the asset created/leased-in. Contractual payments may be in the form of advance payment, progress payment, final payment, annuities and guarantees for receivables, etc. Annuities, in turn, could be with respect to recovering the fixed cost or for recovering both variable cost and the fixed cost of the project. In the former's case, both the government and the private partner share the risk of running the project.

Grants-in-aid, in turn, can take different forms such as a block grant, capital grant, matching grant, institutional support, etc. Lease agreement licenses, similarly, may allow the concessionaire to recover the cost of construction/operation and maintenance through the levying of user charges. Moreover, in the case of lease agreements, the asset reverts to the government after the expiry of the contract. The agreement would most likely also provide for the condition of asset that would be returned at the end of the contract.

It is unlikely that the government will withdraw from making such payments on account of annual budgeting or changes in government. Once the Government Contract has been executed, both parties would be equally bound by the contractual terms. The doctrine of promissory estoppel would apply to both parties, and if the private party has commenced performance under the Government Contract due to reliance on the promise of the government, then the government would be estopped from terminating the contract or withdrawing from it. In terms of Article 299 of the Constitution of India, the authorized officer executes the Government Contract in the name of the president or the governor, who is not personally liable under the contract, but is officially responsible for it – implying the continuity of the Government Contract until such time that the contract is validly terminated or expires.

**VIABILITY OF SPVS OR TRUST STRUCTURES**

In our view, for the reasons highlighted above, a separate trust or SPV structure would not be required to make or receive payments. Again, the actual terms of the transaction would depend on the terms of the Government Contract.

**6 What happens if a government entity does not execute the whole of its annual budget? Would there be any negative consequences for the entity? If so, would there be legal mechanisms to enable the “freezing” of budget funds?**

**FREEZING OF GOVERNMENT FUNDS/NECESSITY OF SAFEGUARDING AGAINST ANNUAL BUDGET RESTRICTIONS**

Please refer to our response in **Section 5** above. The Indian judiciary has held that paucity or unavailability of funds cannot be sufficient grounds for failure of discharge of public duties by a government body (*Ratlam Municipality v. Vardichand*). Considering the fact that the Government Contract would be executed by the government agency in pursuance of its public function, withdrawing from such a Government Contract would entail penal consequences. Appeal may be made to the relevant dispute resolution body under the Government Contract.

For the same reasons, the CVC has prescribed the creation of a “mobilisation advance” fund, backed by an adequate bank guarantee, as a safeguard against nonpayment or delayed payment of dues by the government agency.

Under the terms of the Government Contract, penal consequences could be imposed on the government entity that does not meet the funding needs of its original commitment. The requirement as to the “freezing” of funds should not arise; the funds will remain available and will get carried over from year to year as per the terms of the government entity’s contractual commitments. We do not believe that any restrictions to or variations in the annual budget of the government entity would affect its commitments under the Government Contract.

## **PART 3: INTERMEDIARY**

**1 If the Intermediary carries out activities as a mere advisor, would the law require the Intermediary to set up a permanent presence in the jurisdiction? If the Intermediary is receiving and administering investors’ money, would the law require the Intermediary to set up a specific type of entity in the jurisdiction?**

**PRESENCE IN INDIA**

Please refer to our responses in **Part 1, Section 1.1** above and **Part 3, Section 2** below. It is advisable that the Intermediary is set up as a registered body in India, with permanent presence in India. Foreign entities may set up business in India by establishing a liaison office, project office, branch office, or as a trading company, a wholly owned subsidiary, or as a joint venture. Depending on the mode of establishment, different rules framed by the RBI under FEMA from time to time would apply. The primary among these is the RBI’s Master Circular dated 1 July 2013 on the “Establishment of Liaison/Branch/Project Offices in India by Foreign Entities.” Further,

although a foreign entity is permitted to set up a branch office in India, subject to prior approval from RBI, we believe it is unlikely for RBI to grant approval in cases where foreign entities propose to set up their operations and service activities (in the present case, technological services) through a “branch office” mode, particularly when presence in India for such activities already exists through subsidiaries.

In our view, it would be advisable to adopt the Social Venture Fund structure, or to set up the Intermediary as a trust, a society or a Section 25 Company. The annexures to this Memorandum of Responses set out the procedural formalities and requirements for such structures.

## 2 What types of entities are available in the jurisdiction?

### POSSIBLE STRUCTURE TYPES FOR THE INTERMEDIARY IN INDIA

We have already discussed the possible transaction structures in line with the Instiglio model in **Part 1, Section 1.1** and **Part 3, Section 1** hereto. To summarise briefly again, the Intermediary may be set up as a Social Venture Fund, a trust, a society or a Section 25 Company in India. It is advisable that the Intermediary is set up as a registered body in India, with permanent presence in India. The annexures to this Memorandum of Responses set out the procedural formalities and requirements for such structures. Further, a comparative table of the key differences between these various types of structures has been set forth in Annexure F.

## 3 Assuming that the Intermediary will receive funding (either through equity or loans) and will use them for the advancement of social projects, could the law of the jurisdiction consider that the Intermediary is carrying out financial intermediation activities or any other sort of regulated activity? What thresholds apply (if any) for being considered a regulated entity (i.e., under financial regulations)?

### WHETHER THE INTERMEDIARY WOULD BE CONSIDERED A FINANCIAL INTERMEDIARY/ ANY OTHER REGULATED ENTITY

The Intermediary under the Instiglio model may act as a financial advisor, or as a nonfinancial advisor, depending on the precise nature and scope of its activities.

If the Intermediary is providing financial services or advice on financial aspects, then, in accordance with the Intermediary’s role and offered services, it may be required that separate registration be obtained by such Intermediary. For such financial Intermediaries, various sector-specific or exchange-control restrictions may apply. For instance, an Intermediary that provides investment advisory services (to its foreign investors) may need to be registered under the SEBI (Investment Advisor) Regulations, 2012. The Intermediary may also be required to fulfil certain other prudential norms, such as minimum capitalisation requirements, etc. More specific advice may be given on such consequences for a better understanding of the precise nature of activities to be carried out by the Intermediary.

Given that the Intermediary under the Instiglio model would be specifically advising on financial modelling, etc., it may be construed as providing financial consulting/investment advice under Indian law. However, it would be useful to know the universe of activities contemplated by the Intermediary before drawing such an inference.

#### **4 Does the law of the jurisdiction set forth foreign exchange constraints or mechanisms for remitting money into the jurisdiction and converting it into local currency?**

##### **LEGAL RESTRICTIONS ON THE REMITTANCE OF MONEY INTO INDIA**

Fund transfers between a resident and a nonresident (or vice versa) are governed by the provisions of the FEMA. The FEMA and the regulations made thereunder by the RBI from time to time regulate the manner, limits and permissibility of funds transfer from India to abroad and vice versa.

FEMA classifies transactions between Indian residents and nonresidents in two categories: (i) current account transactions; and (ii) capital account transactions. A “capital account transaction,” under the FEMA is a transaction that alters the assets or liabilities, including contingent liabilities, outside India, of persons residing in India or assets or liabilities in India of persons located outside India. A “current account transaction” is any transaction other than a “capital account transaction,” and typically involves transactions entered into between residents and nonresidents in the ordinary course of business (including general commercial payment transactions). Both these types of transactions have been discussed in some detail in Annexure A hereto.

The principle under FEMA is that: (a) a “current account transaction” is generally permitted for payments in the ordinary course of business and commercial trade (provided that such transactions are not prohibited under the schedules to the CAT Rules); and (b) unlike a current account transaction, a “capital account transaction” cannot be automatically undertaken; it requires a prior review by the concerned parties before it is effected. The limits on the total amount of funds a person in India may receive would largely depend on various factors, such as the category of transactions, purpose of such fund transfer, nature of beneficiary, and the sector/business of the recipient. Given that India is an exchange-controlled jurisdiction, the payment or receipt of such funds would need to be analysed on a case-by-case basis, in view of the limits and regulations laid down in the CAT Rules and PCAT Rules, as well as the other applicable FEMA norms (as applicable to nonresidents looking to carry out transactions in India).

##### **LEGAL RESTRICTIONS ON THE CONVERSION OF MONEY INTO LOCAL CURRENCY**

The Indian rupee is not tied or pegged to any other foreign currency (or basket of foreign currencies). It is also not freely convertible and the Foreign Exchange Management Act, 1999 (including the rules and regulations framed thereunder by the Reserve Bank of India [RBI] from time to time) prescribe the applicable restrictions on foreign exchange transactions.

You may note that while current account transactions involving inflow or outflow of foreign currency are subject to relatively few controls and restrictions, there are many regulations that control and calibrate capital account transactions involving the inflow or outflow of foreign currency.

The RBI, in its publication of the exchange control manual made on 30 May 2005 (ECM), has issued a chapter on permitted currencies and the methods of payment. The ECM states that "... 'permitted currency' is used in the manual to indicate a foreign currency which is freely convertible i.e., a currency which is permitted by the rules and regulations of the country concerned to be converted into major reserve currencies like U.S. Dollar, Pound Sterling and for which a fairly active market exists for dealings against the major currencies. Accordingly, authorised dealers may maintain balances and positions in any permitted currency. Authorised dealers may also maintain positions in Euro of the European Currency Area." The ECM also states that the authorised dealers may be advised that settlement of payments in terms of the contracts will eventually have to take place in a "permitted currency."

In effect, the authorised dealer banks in India are permitted to convert and settle payments in either the local currency (i.e., INR) or any permitted currency (i.e., a foreign currency that is freely convertible; for example. US dollars, sterling, euro, Australian dollars, etc.) in accordance with the relevant FEMA rules.

## **5 If the Intermediary requires bringing foreign personnel into the jurisdiction, please discuss briefly what types of visas/permits may be required.**

### **VISAS/PERMITS REQUIRED FOR ENTRY OF INTERMEDIARY'S PERSONNEL INTO INDIA**

All foreign personnel must possess a valid passport, accredited travel documents and a valid visa granted by the Indian embassy in the country of their residence. There are mainly four types of visas that may be granted to foreigners. Business visas are valid up to five years, but for a cumulative period of 180 days, while Employment Visas or work permits are valid for up to 1 year and thereafter, are periodically renewable. The "X" Visa may be granted to persons whose category is as of yet unclear, which may later be converted into appropriate category. Further, foreign nationals and their family members who intend to stay in India for more than 180 days or have a visa for more than 180 days must also get themselves registered for a residential permit with the Foreigners' Regional Registration Office.

These visas are granted under and are governed by Registration of Foreigners Act, 1939 and the rules framed thereunder the Passport (Entry in India) Act, 1920 and the Foreigners Order, 1948. Detailed guidelines are available on the website of the [Indian Bureau of Immigration](#) [🔗](#).



**6 Assuming that the Intermediary has been already set up as an entity in the jurisdiction, please discuss briefly what types of visas/permits would be required for it to engage overseas personnel for work in the jurisdiction.**

**VISAS/PERMITS REQUIRED FOR THE ENGAGEMENT OF INTERMEDIARY'S PERSONNEL ABROAD**

Besides the requisite visas/registrations/permits discussed above in Section 3.6, foreign personnel working in India must also obtain tax registration (permanent account number or "PAN"), and may also be subject to service tax payment. No other specific permission of the government or of RBI is required for a foreign national to take up employment in India. However, remittance of funds by foreign nationals out of India would have to meet the requirements stipulated under the FEMA, the CAT Rules, the PCAT Rules and the other regulations framed under FEMA.

**7 Is there any requirement for Intermediary's directors/officers in the Jurisdiction to be national or residents of the Jurisdiction?**

**LEGAL RESTRICTIONS ON THE NATIONALITY OF THE INTERMEDIARY'S DIRECTORS/OFFICERS**

The government of India does not prescribe that employees or personnel of a specific company or sector be of Indian nationality only, except for key strategic industries, such as defence. No approval or permit has to be sought in relation to the employment of foreign nationals.

However, in the event the Intermediary has been set up as a company, there is a requirement under the Companies Act, 2013 that decrees it must have at least one director who has stayed in India for a total period of at least 180 days in the previous calendar year. Similar requirements may apply to the directors, members or officers of other legal structures of the Intermediary, and restrictions dependent on the sector of the Service Provider may also apply.

## **PART 4: SERVICES PROVIDERS**

**1 Assuming that the Intermediary signs a contract with the government, would the law allow the Intermediary to freely choose and contract with the service provider? Would the contract with the government restrict the choice of service provider made by the Intermediary?**

**LEGAL RESTRICTIONS ON CONTRACTS BETWEEN THE INTERMEDIARY AND THE SERVICE PROVIDER(S)**

Please refer to our views in **Part 1, Section 1.2** in relation to the scope and enforceability of Government Contracts. Freedom of contract is a basic principle of the Contract Act. The Intermediary may choose the relevant Service Provider for its further contracts. However, the choice of the Service Provider may be subject to the terms of the

Government Contract. For instance, the requirements for prequalification, which are basic eligibility criteria for the private contractor during a bidding process, may require that the subsequent Service Providers that the Intermediary contracts with must belong to a specific sector, must have a track record, asset size or net profits to be of specific value, and so forth. Thus, it would be difficult to make a blanket assumption about the selection of the Service Provider.

As mentioned previously in **Part 1, Section 1.6** and in **Part 2, Section 4**, the Integrity Pact prescribes that the use of any brokers, agents, Intermediaries, and even subcontractors would entail necessary due disclosure to the relevant government entity before the commencement of the actual bidding process. On the basis of such disclosures by the Intermediary, the government entity may choose to make further enquiries, or even impose certain restrictions on the choice of the Service Provider. It would not be possible to preconceive or enumerate the government's further requirements at this point. However, once the requisite due disclosures have been made, the Integrity Pact signed and the relevant commitment contracts with subcontractors executed, we see no bar on the employment of Service Providers by the Intermediary (i.e., the prospective bidder).

## **2 Is there a substantial risk that services providers' personnel could be re-characterized as employees of the Intermediary? What mechanisms are available for reducing/managing this risk?**

### **NATURE OF EMPLOYEES OF SERVICE PROVIDERS AND INTERMEDIARY**

It is unlikely that the employees of the Service Providers would be treated as employees of the Intermediary for the duration of the contract.

There is a possibility that such employees may be treated as "contract labourers" of the Intermediary, where such "contract labourers" have been defined as workmen who have been hired for or in connection with the work of an establishment by or through a contractor, with or without the knowledge of the principal employer. In this context, a "contractor" means a person who undertakes to produce a given result for the establishment, other than a mere supply of goods or articles of manufacture to such establishment, through contract labour or who supplies contract labour for any work of the establishment and includes a subcontractor. Such contract labourers are regulated by the terms of the Contract Labour (Regulation and Abolition) Act, 1970 (the CLRA). Assuming the Service Provider is a "contractor" and the Intermediary, the "principal employer," the terms of the CLRA would have to be complied with by the Intermediary.

The CLRA applies to every establishment employing 20 or more persons who are employed or were employed on any day of the preceding twelve months as contract labour, and to every contractor who employs or who employed on any day of the preceding twelve months, 20 or more workmen. The CLRA requires that every such principal employer must be registered under the statute. Any failure to obtain

registration under the CLRA or any contravention of its provisions or the rules made under the CLRA for prohibiting, restricting or regulating the employment of contract labour, or any contravention of any condition of a licence granted under the CLRA, will render the principal employer liable to conviction, imprisonment for the officer in charge, and a fine that may be as much as INR1,000 (with an additional fine of INR100 (one hundred rupees) per day for a continuing offence).

It would therefore be advisable to discuss with the concerned Service Provider the status of the workmen that it employs, and to examine whether such Service Provider would be a “contractor” under the terms of the CLRA.

## ANNEXURE A: FOREIGN CONTRIBUTIONS

The provision of grants by a person residing outside India to a person residing in India is primarily governed by the FEMA and the regulations issued thereunder, and the provisions of the FCRA. The purpose of the FCRA is to regulate foreign contribution or foreign hospitality by certain individuals or companies and to prohibit the acceptance and utilisation of such foreign contribution for any activities that is detrimental to national interest.

### 1 FOREIGN CONTRIBUTION

The FCRA defines “foreign contribution” as the donation, delivery or transfer made, either directly or through one or more persons, by any foreign source<sup>1</sup> of —

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1 “Foreign source” includes:

- (i) the government of any foreign country or territory and any agency of such government;
- (ii) any international agency, not being the United Nations or any of its specialized agencies, the World Bank, International Monetary Fund or such other agency as the Central Government may, by notification, specify in this behalf;
- (iii) a foreign company;
- (iv) a corporation, not being a foreign company, incorporated in a foreign country or territory;
- (v) a multinational corporation;
- (vi) a company within the meaning of the Companies Act, 1956, and more than one-half of the nominal value of its share capital is held, either singly or in the aggregate, by one or more of the following, namely:— (A) the government of a foreign country or territory; (B) the citizens of a foreign country or territory; (C) corporations incorporated in a foreign country or territory; (D) trusts, societies or other associations of individuals (whether incorporated or not), formed or registered in a foreign country or territory; and (E) foreign companies;
- (vii) a trade union in any foreign country or territory, whether or not registered in such foreign country or territory;
- (viii) a foreign trust or a foreign foundation, by whatever name called, or such trust or foundation mainly financed by a foreign country or territory;
- (ix) a society, club or other association of individuals formed or registered outside India;
- (x) a citizen of a foreign country.

“Association” means an association of individuals, whether incorporated or not, with an office in India and includes a society, whether registered under the Societies Registration Act, 1860 (21 of 1860), or not, and any other organisation, by whatever name called.

- a) any article, not being an article given to a person as a gift, with market value that exceeds INR25,000;
- b) any currency, whether Indian or foreign;
- c) any securities transferred by a foreign source;
- d) interest accrued on any foreign contribution.

However, foreign contribution excludes fees received by any person from any foreign source (or the agent of such foreign source) in India, in lieu of goods or services rendered by such person in the ordinary course of his or her business, whether within India or outside India.

In this respect, it should be noted that “foreign donation” should not be confused with “foreign investment.” Foreign investment is any investment by nonresident entity / person resident outside India into an Indian company, which is primarily of two forms – FDI, foreign institutional investment under the portfolio investment scheme (FII), and FVCI. Each type of foreign investment is governed by a separate set of norms under the FEMA framework.

#### ELIGIBLE RECIPIENTS OF FOREIGN CONTRIBUTIONS

In the event the Investors choose to make donations to the Intermediary (or to the Service Providers directly) in the form of Foreign Contributions, then they would constitute a foreign source under the FCRA. A foreign source may donate to the following persons only:

- (i) an individual
- (ii) a Hindu undivided family
- (iii) an association with a definite cultural, economic, educational, religious or social programme
- (iv) a company registered under [SECTION 25 OF THE COMPANIES ACT, 1956](#) (akin to Section 8 company under the New Act) (“Section 25 Companies”)

Such a person must have a definite cultural, economic, educational, religious or social programme, and must obtain the prior permission of the central government, or must get itself registered with the central government.

A person residing outside India may invest by way of contribution to the capital of a firm or a proprietorship concern or an association of persons in India.

#### CONDITIONS AND REQUIREMENTS TO RECEIVE FOREIGN CONTRIBUTIONS

In terms of FEMA and the regulations issued thereunder, the provision of a Foreign Contribution by a person residing outside India to a person residing in India should not require the prior approval of the Foreign Investment Promotion Board (FIPB) or the RBI.

However, no person may accept Foreign Contributions unless:

- (i) it registers itself with the central government in accordance with the rules made under FCRA;
- (ii) it agrees to receive such foreign contributions only through such one of the branches of a bank as it may specify in its application for such registration;
- (iii) It confirms that it would not be utilising the Foreign Contributions for any political or religious purposes.

Foreign Contribution may only be made to a person who has registered with the FCRA from the central government. The FCRA sets out certain conditions that need to be satisfied to be granted such registration:

- (i) The applicant is not fictitious or benami.
- (ii) The applicant has not been prosecuted or convicted for indulging in activities aimed at conversion through inducement or force, either directly or indirectly, from one religious faith to another.
- (iii) The applicant has not been prosecuted or convicted for creating communal tension or disharmony in any specified district or any other part of the country.
- (iv) The applicant has not been found guilty of diversion or malversation of its funds.
- (v) The applicant is not engaged or likely to engage in the propagation of sedition or advocate violent methods to achieve its ends.
- (vi) The applicant is not likely to use the Foreign Contributions for personal gains or divert it for undesirable purposes.
- (vii) The applicant has not contravened any of the provisions of this Act.
- (viii) The applicant has not been prohibited from accepting Foreign Contributions.
- (ix) The applicant has undertaken reasonable activity in its chosen field for the benefit of the society for which the foreign contribution is proposed to be utilised.
- (x) In the case of the applicant being an individual, such individual has neither been convicted under any law for the time being in force nor prosecuted for any offence pending against such individual.
- (xi) In the case of the applicant being other than an individual, any of its directors or office bearers has neither been convicted under any law for the time being in force nor is prosecuted for any offence pending against such individual.
- (xii) The applicant, being granted registration, should not prejudicially affect -
  - a) the sovereignty and integrity of India; or
  - b) the security, strategic, scientific or economic interest of the State;
  - c) the public interest; or

- d) freedom or fairness of election to any Legislature; or
- e) friendly relations with any foreign state; or
- f) harmony between religious, racial, social, linguistic, regional groups, castes or communities;
- g) the acceptance of foreign contribution shall not: (x) lead to incitement of an offence; (y) shall not endanger the life or physical safety of any person.

#### RENEWAL OF CERTIFICATE

A certificate of registration to receive foreign contributions is granted for a period of five (5) years. Six (6) months prior to the expiry of the certificate of registration, such certificate is required to be renewed. The central government is required to renew the certificate of registration within ninety (90) days from the receipt of application for the same. In the event the central government does not renew the certificate, reasons for such refusal are required to be given in writing.

#### CAP ON ADMINISTRATIVE EXPENSES

The FCRA has placed a cap of 50 percent of foreign funds for administrative expenses. The central government is expected to define what constitutes administrative expenses. This cap may be exceeded with prior permission.

#### BANK ACCOUNTS

Registered persons may only receive foreign contribution in a single account of a specified branch of a bank. However, the FCRA permits opening multiple bank accounts for the utilization of such funds. Thus, the proposed amendment allows voluntary groups and associations to open multiple bank accounts to disburse the funds received from abroad. However, such foreign contributions can still be received only through the designated bank account.

#### FOREIGN CONTRIBUTIONS AS CURRENT ACCOUNT TRANSACTIONS

The Foreign Exchange Management (Current Account Transactions) Rules, 2000 ("CAT Rules") lay down the guidelines for current account transactions. Current account transactions have been defined under FEMA to mean any transaction other than a capital account transaction and these include:

- (i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business;
- (ii) payments due as interest on loans and as net income from investments;
- (iii) remittances for living expenses of parents, spouse and children residing abroad; and
- (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children.

Any transaction in foreign exchange falling under Schedule I of the CAT Rules is prohibited. Any transaction falling under Schedule II of the CAT Rules requires prior approval of the government of India. Any transaction falling under Schedule III to the CAT Rules requires the prior approval of the RBI. In Schedule III, Entry 3 pertaining to “Gift remittance exceeding USD5,000 per remitter/donor per annum” and Entry 4 pertaining to “Donation exceeding USD1,00,000 per remitter/donor per annum” are of relevance to Foreign Contributions.

A Foreign Contribution by way of cash would essentially constitute a Current Account Transaction, thus attracting the provisions of the CAT Rules.

#### FOREIGN CONTRIBUTIONS AS CAPITAL ACCOUNT TRANSACTIONS

The **FOREIGN EXCHANGE MANAGEMENT (PERMISSIBLE CAPITAL ACCOUNT TRANSACTIONS) RULES, 2000 (“PCAT RULES”)** lays down rules for capital account transactions.

Capital Account Transaction has been defined in FEMA as a transaction that alters the assets or liabilities, outside India of persons residing in India, or assets or liabilities in India of persons resident outside India, and includes transaction relating to:

- (i) transfer or issue of any foreign security by a person residing in India;
- (ii) transfer or issue of any security by a person residing outside India;
- (iii) transfer or issue of any security or foreign security by any branch, office or agency in India of a person residing outside India;
- (iv) any borrowing or lending in foreign exchange in whatever form or by whatever name called;
- (v) any borrowing or lending in rupees in whatever form or by whatever name called between a person residing in India and a person residing outside India;
- (vi) deposits between persons resident in India and persons resident outside India;
- (vii) export, import or holding of currency or currency notes;
- (viii) transfer of immovable property outside India, other than a lease not exceeding five years, by a person residing in India;
- (ix) acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person residing outside India;
- (x) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred –
  - a) by a person residing in India and owed to a person residing outside India; or
  - b) by a person residing outside India.

Schedule I to the PCAT Rules pertains to persons resident in India while Schedule II to the PCAT Rules pertains to persons who are resident outside India. Only transactions

under Schedules 1 and 2 of the PCAT Rules are permissible. For transactions under Schedule 1 by resident individuals, the rules prescribe a limit of USD2,000,000 per financial year.

A Foreign Contribution made in kind or in the form of securities would constitute a Capital Account Transaction and would be governed by the PCAT Rules.

#### FOREIGN CONTRIBUTIONS TO SECTION 25 COMPANIES

Section 25 companies are non-profit organizations established under Section 25 of the Companies Act, 1956, or Section 8 of the recently enacted Companies Act, 2013. Infusion of foreign capital in a Section 25 company is treated as Foreign Contribution under FCRA. Thus, as most of the Service Provider companies in India (as envisaged in terms of this Memorandum) are Section 25 companies, direct investments by the Intermediary (or indirect investments by the Investors) into the Service Provider companies would constitute Foreign Contribution.

Conversely, in the case the Intermediary is a foreign owned and controlled entity incorporated in India, investment by such foreign-owned and controlled entity<sup>2</sup> is not considered as foreign investment, but it is required to comply with certain limited provisions, but is also given certain exemptions under Indian laws. Investment by an Indian incorporated but foreign owned and controlled company into a Section 25 company would not be considered a Foreign Contribution.

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2 In terms of the Consolidated Policy on Foreign Direct Investment issued by the Department of Industrial Policy and Promotion, government of India on April 5, 2013 ("FDI Policy"), a company is considered "foreign owned" in the event more than 50 percent of its capital is beneficially owned by nonresidents and /or foreign companies, or companies that are ultimately owned or controlled by nonresidents or foreigners. The company would be considered "foreign controlled" if the non-residents and/or foreign companies have the power to appoint a majority of its directors in that company.



## PART 1: INVESTORS

### 1 FUNDING AND PROCUREMENT

- 1.1 Does the law of your jurisdiction allow donors in general (regardless of their legal nature [e.g., straight-out donors or social investors] to fund SIB schemes by directly delivering funds to an Intermediary (either as equity or loans)? Does the law prohibit or limit funding of social service programs? Would the law limit the structure in which the funding is made or the amounts to be funded? What legal formalities would apply to the delivery of funds to an Intermediary (e.g., notarial proceedings)?**

For purposes of tax benefit entitlements, donations are especially regulated under Chilean law. In this regard, [LAW 19,885](#) encourages the adequate use of donations that give rise to tax benefits and extends them to other social and public purposes.

We estimate that the SIB investors do not qualify as donors for purposes of claiming tax benefits, for which they shall be considered as any other investor looking to get a return on their capital investment.

In **Part 1, Section 2.3**, the designated requirements and limits to qualify for the tax benefits of donations are included.

- 1.2 Given the legal framework under which the government is allowed to enter into agreements, what options, if any, would an investor have when contracting with the government directly?**

The government may celebrate agreements of partnership and cooperation with public or private organizations.

For purposes that a Service Provider that wants to provide services to the state does so, it is necessary that this be accomplished through the *Dirección Chilecompra*, which is the institution that administers the *Sistema de Compras Públicas of Chile*.

- 1.3 Are “hybrid investments” legal or subject to special regulation? Hybrid investments combine equity and debt structures, (i.e., a portion of loaned sums and a portion of direct investment). They could also combine debt and equity; for example, preferred stocks, convertible bonds.**

There is no special legal or regulatory treatment for “hybrid investments.”

#### **1.4 What legal framework applies to debt and equity investments? What limitations or procedures apply to bringing in funds to the jurisdiction?**

Cash investments above USD10,000 (ten thousand US dollars), must be properly and timely reported to the Central Bank of Chile, noting under which concept they enter Chile. In addition, remittances from Chile of currency equivalent to USD10,000 or more, must also be previously made known to the Central Bank of Chile.

Earnings paid to a nondomiciled or nonresident of Chile shall be subject to a withholding tax of 35 percent (see **Part 1, Section 2.1**).

#### **1.5 For equity investments, are there quantitative/qualitative legal limitations on the repatriation of profits (e.g., foreign exchange regulations)?**

There are no limitations. There is only the requirement to inform the Central Bank, according to what is stated in **Section 1.4** above.

#### **1.6 Would the independent evaluator's report be binding to the government (i.e., assuming that the government is committed to accepting the outcome of the report, could the government challenge such a report)? What are the contract enforcement concerns and mechanisms to ensure that governments follow their commitment to pay according to an independent evaluator's report? Could the government easily challenge the report? What are the risks?**

In the case the government is contractually obliged to submit to the jurisdiction or determination of an independent evaluator, it must comply with what such evaluator determines.

## **2 TAX ASPECTS**

#### **2.1 What tax rules apply to the funding provided by investors (either donations, loans or equity)? Please consider both loans and equity contributions. Would withholdings apply to the repayment of capital/interest, or dividends/repatriation of equity?**

A company/firm can be financed via debt or equity.

If it is financed by debt, the document evidencing the loan will be subject to stamp tax, which currently is 0.033 percent per month or fraction of a month with a cap of 0.4 percent. If the document is on demand, the applicable tax will be 0.166 percent.

If it is financed via capital, the contribution itself is not subject to any tax. However, the company/firm shall pay a business license ranging from 0.25 percent to 0.5 percent per year, calculated over the tax equity (assets with some adjustments) of the company.

As for the remittal, a distinction will need to be made whether dividends are distributed or capital returns.

Dividends will be subject to a withholding tax of 35 percent on the distributed amount. The first category tax (i.e., corporate tax) may be used as credit.

The return on capital is exempt from withholding tax.

## **2.2 Does the Jurisdiction have international investment agreements, preferential trade or double taxation treaties in force? Are there any on the way of becoming effective (e.g., being negotiated, pending ratification, etc.)?**

Chile has agreements with the following countries to avoid double taxation:

- Australia.
- Belgium
- Brazil
- Canada
- Colombia
- Korea
- Croatia
- Denmark
- Ecuador
- Spain
- France
- Ireland
- Malaysia
- Mexico
- Norway
- New Zealand
- Paraguay
- Peru
- Poland
- Portugal
- United Kingdom
- Russia
- Sweden
- Switzerland
- Thailand

Chile has agreements to avoid double taxation that have been signed, but not yet effective, with the following countries:

- Austria
- United States
- South Africa

All agreements subscribed to by Chile have been made, following the model of the OCDE Convention.

Fiscal, governmental and judicial authorities have strictly complied and adhered to the rules contained in existing treaties.

## **2.3 Are there tax incentives/breaks for socially oriented investing? How cumbersome is the process for obtaining/collecting these incentives?**

There are social incentives for donations made to certain institutions.

On the specific subject of Instiglio, we estimate that this legislation (i.e., donations) does not apply, for which it should be taxed according to the general rules.

According to the provisions of [LAW NO. 19,885](#) (a law that encourages and rules the good use of donations that give rise to tax benefits):

- Taxpayers of first-category tax (Chilean corporate income tax), that declare their actual income based on full accounting, may use a fraction of the amount of the donation actually received as credit.
- Such donations will be released from the insinuación (a preliminary authorization requirement), and will be exempt from the Inheritance and Donations Tax established in [LAW NO. 16,271](#).
- The donor has no obligation to report the donation to the Internal Revenue Service (the IRS), since the law provides that obligation to the grantee. Notwithstanding the foregoing, the donor is required to make available to the IRS the donation certificate issued by the grantee.
- Donations for an amount less or equal to 1,000 Monthly Tax Units (MTU) – equivalent to USD80,000 – will be entitled to a credit equal to 50 percent of those donations, against corporate tax.
- The part of the donations that exceed 1,000 MTU will be entitled to a credit equal to 35 percent of the amount over 1,000 MTU.
- It is important to remember that all donations of an amount less or equal to 1,000 MTU made by a donor to a single institution in a calendar year shall be considered a single grant for the total amount donated in that period for purposes of determining the applicable tax credit.
- The credit to which the donation gives benefits to may only be deducted if the donation is included in the basis of the respective taxes for the year in which the donation was made materially.
- The maximum credit for donations to a single taxpayer may not exceed the amount equivalent to 14,000 MTU that is equivalent to USD1,120,000.

- The part of the donations that cannot be used as credit will be considered necessary expense to produce income, and therefore, will be deductible when determining the net income of the company.
- To access the benefits outlined above, the grantee must be incorporated in the *Registro de Instituciones Donatarias del Ministerio de Desarrollo Social* (the “Register”). They can be part of this Register corporations and foundations that provide direct services to people with low income and/or disabled beneficiaries.

## **2.4 Is it possible to write off losses or to reframe a failed investment in SIBs as a grant/donation? If so, would the grant/donation be subject to taxes?**

We estimate that it is not possible to reframe failed investments as a donation. If the business fails for the investor, it shall be written it off as any other loss.

## **PART 2: GOVERNMENT**

### **1 What is the general structure of the state in your jurisdiction? What degree of autonomy do government entities have for contracting?**

The state of Chile has a single center of political and government direction, which is given by the central government bodies. In view of the foregoing, any negotiations with the state of Chile must be made from the central government (executive power).

The political and administrative authorities can only do what they are expressly permitted by law.

The grades of autonomy of the central government to contract with third parties are relatively low. The Public Procurement System of Chile (see **Part 1, Section 1.2**) together with the regulations in matters of procurements and concessions makes the power of the central authority to contract with third parties fairly regulated.

### **2 Do applicable public procurement rules authorize the implementation of an SIB scheme, i.e., funding social programs by means of an agreement between a government agency and an Intermediary, in which payment from the government would be entirely contingent on the organization achieving measurable and positive social outcomes?**

No applicable regulation exists in Chile for this matter, which leads us to estimate that the central authority may not conclude such agreements.

**3 How does the government of the jurisdiction contract social services? Is public procurement subject to special rules or would it be subject to general and commercial law rules? Is there flexibility in the performance and supervision of contracts by government?**

The public procurement process is highly regulated under Chilean law. Any entity that contracts with the state of Chile must follow the enrolment process in the Public Procurement System aforementioned.

The free will to set the terms of such contracts is very low, and is always subject to the rules of public procurement.

**4 May an Intermediary tender for both design and implementation stages or would there be impediments because of conflict of interests? Would it be possible to combine direct contracting or PPPs with public procurement and, thus, avoid the conflict of interests issue (i.e., Intermediary would either design or implement under a PPP or direct contract and, thus, be able to tender for the remaining stage.)?**

Unless there are specific restrictions contained in the tender bases, there are no restrictions for an Intermediary to tender for different stages of a project.

**5 Does annual budgeting apply? If so, are there legal mechanisms to ensure future payments? Can these mechanisms commit future administrations? Where the law does not readily allow for future payments, could trust structures or special vehicles be set up to make up for any shortfalls in the law?**

All public expense must be based on a previously approved item within the national budget. On the other hand, if the state of Chile subscribes to a contract and it is not fulfilled, forced compliance or a termination of the contract may be requested, both with damage indemnity.

**6 What happens if a government entity does not execute the whole of its annual budget? Would there be any negative consequences for the entity? If so, would there be legal mechanisms to enable the “freezing” of budget funds?**

Clearly, this situation could create a problem for the Intermediary. However, the Intermediary could be sued in the court of justice. The fulfillment of the contract may be enforced, or may be terminated, both with damage indemnity.

## PART 3: INTERMEDIARY

- 1 If the Intermediary carries out activities as a mere advisor, would the law require the Intermediary to set up a permanent presence in the jurisdiction? If the Intermediary is receiving and administering investors' money, would the law require the Intermediary to set up a specific type of entity in the jurisdiction?**

If the Intermediary acts as a mere consultant, it should not need to establish a permanent presence in Chile.

We understand that because of the business structure, only funds from investors will be received to carry out a specific activity. Therefore, it is not strictly necessary to create a special type of entity.

- 2 What types of entities are available in the jurisdiction?**

According to Chilean law, companies, branches or representative offices can be established. The convenience of using one or another form of organization will depend on the structure of the business.

- 3 Assuming that the Intermediary will receive funding (either through equity or loans) and will use them for the advancement of social projects, could the law of the jurisdiction consider that the Intermediary is carrying out financial intermediation activities or any other sort of regulated activity? What thresholds apply (if any) for being considered a regulated entity (i.e., under financial regulations)?**

From the analysis of the proposed business we understand that it has no relationship with the bank business, which is governed by the Chilean law. We understand the nature of this business does not exist in Chile, and there is no specific regulation on the activity.

- 4 Does the law of the jurisdiction set forth foreign exchange constraints or mechanisms for remitting money into the jurisdiction and converting it into local currency?**

All regulations on entering foreign currency to Chile are controlled under the Foreign Exchange Rules of the Central Bank. This compendium regulates the entry and exit of foreign exchange to Chile, as stated above.

- 5 If the Intermediary requires bringing foreign personnel into the jurisdiction, please discuss briefly what types of visas/permits may be required.**

If the Intermediary is required to bring in foreign personnel for less than 90 days, it may request a special work permit for tourists, which allows foreign persons to work for periods of up to 30 days, and is renewable for up to two consecutive 30-day periods,

without exiting the country. If the individual exits the country, the permit expires and must be requested again upon re-entry.

In the case the intended length of stay is longer, and assuming that the foreign personnel are to remain employed abroad, a Temporary Resident Visa would be needed.

Attached to this document are brief overviews of special work permits for tourists, as well as Temporary Resident Visa procedures and documents needed in application.

**6 Assuming that the Intermediary has been already set up as an entity in the jurisdiction, please discuss briefly what types of visas/permits would be required for it to engage overseas personnel for work in the jurisdiction.**

In the case the Intermediary sets up in Chile, all personnel working for the Intermediary under subordination and dependence must have an employment contract. Assuming an employment relationship with the local Intermediary will be required, a Work Contract Visa would be needed, which allows foreign personnel to work for period up to two years. This may be renewed.

Attached to this document is a brief overview of work contract procedures and documents needed in application.

**7 Is there any requirement for Intermediary's directors/officers in the Jurisdiction to be national or residents of the Jurisdiction?**

Chilean law does not require that the directors or senior executives of a company be Chileans or have residency in Chile. However, the legal representative of a company before the IRS must be Chilean or a resident in Chile.

## PART 4: SERVICES PROVIDERS

**1 Assuming that the Intermediary signs a contract with the government, would the law allow the Intermediary to freely choose and contract with the service provider? Would the contract with the government restrict the choice of service provider made by the Intermediary?**

There is no regulation in Chile on this subject. It will depend on the negotiation of the respective contract.

**2 Is there a substantial risk that services providers' personnel could be re-characterized as employees of the Intermediary? What mechanisms are available for reducing/managing this risk?**

They could possibly be considered contractors for the Intermediary. This will depend on the wording of the contract and the type of service provided.



## PART 1: INVESTORS

### 1 FUNDING AND PROCUREMENT

**1.1 Does the law of your jurisdiction allow donors in general (regardless of their legal nature [e.g., straight-out donors or social investors] to fund SIB schemes by directly delivering funds to an Intermediary (either as equity or loans)? Does the law prohibit or limit funding of social service programs? Would the law limit the structure in which the funding is made or the amounts to be funded? What legal formalities would apply to the delivery of funds to an Intermediary (e.g., notarial proceedings)?**

We are not aware of any prohibition in Brazilian law on private donors to fund social programs/activities performed by private entities, even if such programs/activities would normally be funded/performed by the government itself.

Usually, social programs not implemented by the government (in areas such as, but not limited to, education, health, social assistance activities) are developed by not-for profit organizations that can be incorporated as Associations or Foundations (please refer to **Part 3, Section 2** for more information on this matter). In the case the programs/activities are performed by Associations or Foundations, the funding can only be performed through donations in Foundations and Associations. Within this scenario, in very specific cases, the funding may come from loans or from government grants, but in any case, it cannot occur through equity investments.

In cases in which the Intermediary is not a not-for-profit organization, there are no restrictions on equity or loan investments.

Restrictions to note are for the funding of not-for-profit organizations, as mentioned above. If the Intermediary is a regular profit entity, then there is a wide range of investments that can be executed. Also, since there are no restrictions to funding for social programs/activities, the formalities for the delivery of funds to the Intermediary will vary according to the corporate structure of the Intermediary.

The notarial proceedings shall vary with regard to how the investment will be channeled. Donations shall be formalized by means of a private agreement signed by the parties and registered with the competent Registry of Deeds and Documents. The applicable tax must be paid by the receiver of the donation, which amount varies according to the state law where the transaction occurs; Loans will be formalized by means of a private agreement signed by the parties and registered

with the competent Registry of Deeds and Documents; and equity or debt investments shall be in accordance to the procedures described on **Part 1, Sections 1.3, 1.4** and **Part 3, Section 4**.

## **1.2 Given the legal framework under which the government is allowed to enter into agreements, what options, if any, would an investor have when contracting with the government directly?**

As a general rule, [ARTICLE 37, SUBPARAGRAPH XXI](#) of the Constitution establishes that public works, services, purchases and sales must be performed by means of a public bidding procedure. This constitutional provision is regulated by [FEDERAL LAW NO. 8.666](#), dated 21 June 1993 ("Public Procurement Act"), which establishes the conditions for both public bidding procedures and governmental agreements entered into by public administration.

The obligation of contracting through tenders aims to provide equal opportunities to those who are interested in negotiating with the government and respected the standards previously established by the procuring public entity. It presupposes the idea of competition, to be held between those who meet all the conditions and qualities required for the satisfactory execution of the contract.

Therefore, all contracts entered into by public administration necessarily follow a bidding procedure in which the discussions of all terms, methodology and goals are only permitted before the opening of the proposals, during a specific period of time.

Differently from private contracts, a governmental contract is the obligatory document that the Public Administration, in such capacity, enters into with the private parties, individuals or other administration entities in order to reach the proposed public interest objective.

The peculiarity of such a contract is the fact that it is the Administration, observing the legal limits, which establishes the contract terms. The private party is merely required to comply with the conditions imposed if it wishes to enter into the contract. Governmental contracts executed by a private party with any of the entities of the Public Administration always include a so-called "exorbitant clause," as a consequence of the basic principle of the preponderance of public interest over private interest.

The Administration has a different status vis-à-vis the private party, and these "exorbitant clauses" are considered valid and enforceable under Brazilian public law. They include the possibility of unilateral alteration and termination of the contract, as well as the right to inspect compliance with contractual obligations and to apply contractual penalties, such as warnings and fines.

The law assures the private party the right to economic balance or indemnification when applicable. As a result, if the private party is in compliance with its obligations under the contract, any change or amendment by the Administration that impacts the

economic balance of the agreement must be accompanied by compensation for the private party that reinstates such balance.

Nevertheless, private parties are allowed to present and defend the viability of any project to public administration, by means of Manifestation-of-Interest Proceeding (PMI), in the case of concessions (ruled by Law No. 8.987/95) or PPPs. (ruled by Law No. 11.079/2004), as better presented in **Part 2, Section 3**.

In this case, the private partner requests the Granting Authority (union, states, municipalities or state-owned companies) to initiate a PMI process or waits for it to be opened at the public administration's discretion. Once the procedure is opened, the private party prepares a project (feasibility study, legal documents, technical review and basic engineering project or concept, if applicable) and submits it to a Granting Authority (federal, state, municipal or state-owned company), which reviews the project, adjusts it and starts a bid procedure. The private partner author of such a PMI is permitted to participate in the bid procedure.

The winner of the bid, where it is not the party that submitted the project to the Granting Authority, must reimburse the party that submitted the project for a fixed amount established by the Granting Authority. Therefore, even when presenting a viable and interesting project (from a social perspective) to the public administration, there is no guarantee that the party that submitted such project will be the one selected to execute it.

### **1.3 Are “hybrid investments” legal or subject to special regulation? Hybrid investments combine equity and debt structures, (i.e., a portion of loaned sums and a portion of direct investment). They could also combine debt and equity; for example, preferred stocks, convertible bonds.**

Yes, hybrid investments are legal and must follow the special regulation applicable to the debt or equity instruments that comprise the relevant structure of the hybrid investment. As an example, a company established in Brazil may issue no more than 50 percent of its stock capital as preferred shares, which may grant limited voting rights with preferred economic and redemption rights ([ARTICLE 15, SUBSECTION 2, OF LAW NO. 6,404/76](#)). Instruments of debt or equity in Brazil, which would qualify as hybrid investments comprise, but are not limited to warrants, preferred shares, convertible debentures, perpetual debentures and participation certificates. Hybrid investments could be created as well by combining the instruments described above, as well as with direct investments and loans in the company, as described in our answer to **Section 1.4** below.

### **1.4 What legal framework applies to debt and equity investments? What limitations or procedures apply to bringing in funds to the jurisdiction?**

The legal framework applicable to equity and debt investments may differ, depending on the target and type of the foreign investment. Broadly speaking, foreign direct investments and loans are regulated by the [LAW NO. 4.131 OF 1962](#) (“Law on Foreign

Investments”), whereas the foreign investment within the Brazilian capital and financial markets, including in publicly held companies, is regulated by the Resolution of the [NATIONAL MONETARY COUNCIL](#) (“CMN”, after its acronym) [NO. 2.689 OF 2000](#) (“CMN RESOLUTION 2,689”).

The inflow or outflow of funds to or from Brazil is subject to registration with the Central Bank of Brazil (“BACEN,” after its acronym) pursuant to the CMN Resolution [NO. 3.844 OF 2010](#), which provides for: (i) direct investments; (ii) foreign credit transactions, including foreign financial leasing transactions; (iii) royalties, technical services and similar activities, leasing, foreign operational leasing, rental fees; (iv) collateral given by international organisms; and (v) cash in foreign currency.

Direct foreign investment in privately held companies or loans pursuant to the Law on Foreign Investments are required to be registered with BACEN through a declaratory electronic registration. Such registration must be concluded within 30 days of the entrance of the funds in Brazil. The remittance of the funds to Brazil must be carried out by a financial institution duly authorized by BACEN to perform exchange transactions.

In respect to foreign investment within the Brazilian financial and capital markets, the nonresident investor must be registered with Brazilian Securities Commission (“CVM”, after its acronym) and the inflow and outflow of funds will also be subject to registration with BACEN. Pursuant to CMN Resolution 2,689, in order to invest in the Brazilian capital and financial markets, nonresident investors must: (i) appoint a representative in Brazil, which shall be liable for the nonresident investor’s compliance with the rules issued by CVM and the Brazilian tax law; and (ii) engage a custodian, duly authorized with CVM.

In general, foreign investors are entitled to the same investment opportunities available to Brazilian residents. The dividends and profits derived from such investments will receive the same legal treatment, regardless if they are remitted abroad or not, provided that the remittance of such profits abroad is registered with BACEN.

### **1.5 For equity investments, are there quantitative/qualitative legal limitations on the repatriation of profits (e.g., foreign exchange regulations)?**

There are no restrictions applicable to the repatriation of profits and dividends, provided that such remittance of profits and dividends is registered with BACEN.

For applicable tax law, please check **Part 1, Section 2.1**.

**1.6 Would the independent evaluator's report be binding to the government (i.e., assuming that the government is committed to accepting the outcome of the report, could the government challenge such a report)? What are the contract enforcement concerns and mechanisms to ensure that governments follow their commitment to pay according to an independent evaluator's report? Could the government easily challenge the report? What are the risks?**

It is important to bear in mind that the public administration has the obligation to respect the public interest and several principles that govern its actions. By executing a partnership or any kind of agreement with public money, the public administration has to comply with strict rules and to aim for specific goals. All administrative acts will be constantly supervised, both internally by the acting administration and externally by legal courts and public officers, etc.

Supervision of the services rendered by private parties and the persecution by a private party of public interest (in accordance with a public agreement) is a duty of the public administration, being unsusceptible of delegation to private parties under constitutional principles.

This supervision, nevertheless, will have to be done in an objective manner, presenting all necessary fundamentals that ground any decision.

Therefore, it is important that all the objectives and results that should be achieved by the project are dealt in depth by the agreement to be arranged. This will reduce the discussion on whether the project had or had not produced such results.

A complete and well-grounded analysis of an independent evaluator will contribute to minimizing the discussion whether the project had or had not achieved the necessary results. But the final decision on this regard will be made by the government and can be discussed by the supervising bodies, which will have to present very strong arguments to decide against what the independent evaluator had presented.

The agreement can involve an independent evaluator who will analyse the projects results accordingly to those well- and objectively defined elements.

## **2 TAX ASPECTS**

**2.1 What tax rules apply to the funding provided by investors (either donations, loans or equity)? Please consider both loans and equity contributions. Would withholdings apply to the repayment of capital/interest, or dividends/repatriation of equity?**

### **FUNDING THROUGH LOANS**

Funding provided by foreign investors through loans shall be subject to the tax on foreign exchange transactions (IOF/FX). IOF/FX is levied on most transactions involving

the conversion of foreign currency into Brazilian currency (reais), or on the conversion of reais to foreign currency. In the case of funding through loan transactions, the amounts remitted from the foreign investor to Brazil shall be subject to IOF/FX at either a 0 percent rate (in the case of transactions with durations greater than 360 days) or 6 percent for shorter-term transactions. IOF/FX rates may be increased at any time up to 25 percent for monetary policy purposes with prospective effects.

Also, payments by a Brazilian party to a non-Brazilian resident of interest on loans are subject to WHT of 15 percent (or 25 percent, if the beneficiary is domiciled in a Favorable Tax jurisdiction<sup>1</sup>). Nevertheless, it is important to bear in mind that in relation to loans executed between a Brazilian company and a related party, or any third party domiciled in a Favorable Tax jurisdiction or with a Privileged Tax Regime,<sup>2</sup> interest expense deductibility will be subject to transfer pricing and thin capitalization rules.

### FUNDING THROUGH EQUITY

In the case of funding provided by foreign investors to be carried out through equity, the IOF/FX would be levied at 0.38 percent for both inflow (capital increase) and outflow (repatriation of capital), while the outflow of dividends will be subject to a 0 percent rate. IOF/FX rates may be increased at any time up to 25 percent for monetary policy purposes, with prospective effects.

### GENERAL TAXATION OF INCOME AND GAINS OF NON-BRAZILIAN RESIDENTS

Regarding the taxation of income and gains of non-Brazilian residents, dividends with respect to profits generated and payable by the Brazilian company to its foreign shareholders are generally not subject to WHT in Brazil. Likewise, Brazilian companies have the option of paying interest on shareholders' equity as an alternative form of remuneration of its shareholders. For tax purposes, payment is based on the long-term interest rate (TJLP) determined by the Bacen, applied to shareholders' equity and

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1 Pursuant to Brazilian tax legislation, any jurisdiction that does not tax income or that taxes income at a maximum rate lower than 20 percent, or where local legislation imposes restrictions on the disclosure of the identities of shareholders, the ownership of the investment, or the identity of the beneficial owner of the income ascribed to nonresidents, such jurisdiction can be classified as a "Favorable Tax Jurisdiction," although this qualification may vary according to each specific case, as defined by applicable legislation. The Brazilian tax authorities have listed the following as Favorable Tax Jurisdictions: Andorra; Anguilla; Antigua and Barbuda; the Netherlands Antilles; Aruba; Ascension Island; the Bahamas; Bahrain; Barbados; Belize; Bermuda; Brunei; Campione D'Italia; the Channel Islands (Alderney, Guernsey, Jersey, and Sark); the Cayman Islands; Cyprus; Singapore; the Cook Islands; Costa Rica; Djibouti; the Dominican Republic; the United Arab Emirates; Gibraltar; Granada; Hong Kong; Kiribati; Labuan; Lebanon; Liberia; Liechtenstein; Macau; Madeira; the Maldives; the Isle of Man; the Marshall Islands; Mauritius; Monaco; Montserrat; Nauru; Niue; Norfolk Island; Oman; Panama; Pitcairn Island; French Polynesia; the Queshm Islands; St. Kitts and Nevis; St. Helena; St. Pierre and Miquelon Island; Solomon Island; the Kingdom of Swaziland; Tristan da Cunha; American Samoa; Western Samoa; San Marino; St. Lucia, St. Vincent and the Grenadines; the Seychelles; Tonga; the Turks and Caicos Islands; Vanuatu; the U.S. Virgin Islands, and the British Virgin Islands.

2 "Privileged Tax Regimes" are considered by the Brazilian tax authorities as: (i) Sociedad Anonima Financiera de Inversion (SAFI), incorporated under Uruguayan law until December 2010; (ii) holding companies incorporated under Danish law and under Dutch law that do not have substantial economic activities; (iii) international trading companies (ITCs) incorporated under Icelandic law; (iv) offshore companies incorporated under Hungarian law (KFT); (v) LLCs incorporated under US state laws (in which membership interests are held by nonresidents who are not subject to US federal income tax); (vi) Entidad de Tenencia de Valores Extranjeros (ETVEs) incorporated under Spanish law; (vii) and ITCs and international holding companies (IHCs) incorporated under Maltese law. In principle, the "Privileged Tax Regime" rules will be applied solely for purposes of the observance of transfer pricing and thin capitalization rules.

subject to certain legal requirements. Expenses for such interest are deductible for purposes of Corporate Income Tax (IRPJ) and Social Contribution Tax on Net profits (CSLL) (taxes levied on the company's profits) calculation, resulting in a net tax benefit to the company. The payment of such interest is subject to WHT of 15 percent (or 25 percent, if the beneficiary is domiciled in a Favorable Tax Jurisdiction).

Last, as a general rule, any capital gains earned by non-Brazilian residents in transactions involving the disposal of Brazilian assets are subject to tax in Brazil at a rate of 15 percent (or 25 percent if the beneficiary is domiciled in a Favorable Tax Jurisdiction.)

#### CORPORATE TAXATION IN BRAZIL

Should a Brazilian entity achieve its goals and therefore receive the amounts agreed upon under the Contract signed with the Brazilian government, such amounts are likely to be considered taxable income arising from service agreements and therefore will be subject to the following taxes: (i) IRPJ and CSLL at a combined 34 percent rate; (ii) Contribution Tax to the Social Integration Program (PIS) and the Social Security Financing Contribution Tax (COFINS) at a combined rate of 3.65 percent or 9.25 percent; and (iii) Service Tax (ISS) at rates that might vary from 2 percent to 5 percent according to the local (municipal) legislation in which the provider is domiciled or the service is rendered. Although taxation described above represents the general tax burden of Brazilian entities regarding income arising from service agreements, it is important to bear in mind that under the context of SIB activities, tax incentives might be considered case by case, as mentioned further in **Part 1, Section 2.3**.

### **2.2 Does the Jurisdiction have international investment agreements, preferential trade or double taxation treaties in force? Are there any on the way of becoming effective (e.g., being negotiated, pending ratification, etc.)?**

With a view toward the avoidance of double taxation, Brazil has entered into treaties with the countries listed below. These treaties generally follow in most part the model of the Organization for Economic Cooperation and Development (OECD).

Brazil's treaty partners are: Argentina, Austria, Belgium, Canada, Chile, China, Czech Republic, Denmark, Ecuador, Finland, France, the Netherlands, Hungary, India, Italy, Israel, Japan, Korea, Luxembourg, Mexico, Norway, Peru, the Philippines, Portugal, Slovak Republic, South Africa, Spain, Sweden, and Ukraine.

### **2.3 Are there tax incentives/breaks for socially oriented investing? How cumbersome is the process for obtaining/collecting these incentives?**

#### TAX ASPECTS OF NOT-FOR-PROFIT ORGANIZATIONS

Most of the not-for-profit organizations with public aims registered in Brazil are entitled to enjoy tax and other legal benefits. Tax benefits are provided to both Associations and foundations.



**Immunity.** The Brazilian Constitution states that the union, states, federal district and municipalities may not tax educational and social assistance not-for-profit private legal Associations or Foundations.

**Exemption.** Associations and Foundations may be awarded exemption from corporate income taxes (– IRPJ/CSLL) and from COFINS revenue tax, as well as be granted a reduced PIS tax rate. The requirements for exemption is that the entities: (i) have a philanthropic, recreational, cultural or scientific character; or (ii) are civil Associations that provide services relating to their corporate purpose and allow parties forming the association access to the entity; and, (iii) among other few rules;

- a) do not compensate their administrators for the services provided;
- b) entirely apply their resources in the maintenance and development of their corporate purposes;
- c) maintain full accounting registers in compliance with formal requests;
- d) maintain, in good shape for over five years, the documents that support their accounting registers; and
- e) annually file their income tax returns in accordance with the rules of the tax authorities;

#### TAX BENEFITS OF NOT-FOR-PROFIT ORGANIZATIONS

With respect to tax benefits granted to donors, **FEDERAL LAW NO. 9,249/95** provides that all donations from corporate entities to not-for-profit organizations meeting certain requirements provided by law (“Qualified Institutions”) be deductible from the corporate entity’s operational income, limited to 2 (two) percent of the amount of such operational income. It should be noted that only donors that calculate their income tax obligations through the *lucro real* (a form of calculation that differs from a more simple form based on a presumed annual income) may benefit from such deductibility.

As a result, donors benefit by reducing the amount of their operational income, which is the basis for the calculation of their income tax and social contribution obligations. This deductibility generally provides the donor with a 34 (thirty four) percent return on the amount donated in the form of a reduction in their income tax and social contribution obligations, meaning that for each BRL100.00 (one hundred reais) donated the donor has a reduction of approximately BRL34.00 (thirty-four reais) in their income tax and social contribution obligations.

In addition, companies donating to educational or research institutions may also benefit from tax deductibility in the same manner as donations made to Qualified Institutions, except that the deductibility is limited to 1.5 percent (one point five percent) of the donor’s operational income.

In the federal level, there are also tax benefits related to cultural, sports, health, the elderly and children, and youth projects.



The most well-known tax incentive is related to cultural projects. According to [FEDERAL LAW NO. 8,313/91](#) (also known as the “Rouanet Statute”), legal entities can deduct, as expenses, the amount granted (as donations or sponsorship) to cultural projects approved by the Ministry of Cultural Affairs. Furthermore, the legal entity can deduct part of the amount granted from its Income Tax due (30 percent [thirty percent]) in the case of sponsorship and 40 percent (forty percent) in the case of donations), limited to 4 percent (four percent) of the total amount due. In specific segments (such as scenic arts and preservation of material and immaterial cultural heritage), the amount donated to cultural projects can be entirely deducted from the due Revenue Tax, limited to 4 percent (four percent) of the total amount due by the taxpayer. Nonetheless, donations to cultural projects in such segments cannot be deducted as expenses.

States and municipalities can also establish their own tax incentives and they usually benefit cultural and sports projects. For example, the state and the municipality of São Paulo both have rules that benefit companies who donate to cultural projects.

## **2.4 Is it possible to write off losses or to reframe a failed investment in SIBs as a grant/donation? If so, would the grant/donation be subject to taxes?**

In general, Brazilian tax rules allow Brazilian legal entities to use most of its losses as deductible expenses for the purpose of IRPJ and CSLL. It is important to bear in mind that in order to be deductible, such expenses incurred by the Brazilian legal entity shall be necessary, ordinary and customary for upholding the activities and businesses of the company, as well as be necessarily supported by proper and detailed documentation.

In this regard, even though a case-by-case analysis is required, considering a scenario where the Brazilian company registers a loss in its accountancy it might be possible to write off such losses for tax purposes, but if the entity does not have taxable income, it will ultimately end up with a tax loss to be potentially offset in the future against taxable income (subject to certain limitations).

As for the possibility of reframing a failed investment in SIB as a grant/donation, pursuant to the Brazilian tax legislation current in force, such reclassification is not possible.

## **PART 2: GOVERNMENT**

### **1 What is the general structure of the state in your jurisdiction? What degree of autonomy do government entities have for contracting?**

The Brazilian Federal Constitution recognizes four political entities: the Union (as the federal government), the 26 states, the federal district and the municipalities. Each of these political entities is attributed with autonomy. The states and the federal district

have their own Constitution and the municipalities are arranged in accordance with the corresponding organic laws.

The Federal Executive Branch is responsible for the implementation of federal governmental programs and policies. It is composed of both direct administrative bodies, such as the Ministries, and indirect ones, such as public corporations and regulatory agencies.

In the state level, the chief of the Executive Branch is the governor of the state, who has under his or her command secretaries and direct assistants. It is his or her responsibility to represent his or her state, coordinate legal, political and administrative relations, defend the autonomy of the state and command local public security.

The Municipal Executive Branch has the Mayor as its leader. Among his duties are preparing the municipal budget, enforcing municipal public policies, and prioritizing and organizing the provision of public services of local interest and municipal competence, such as transportation, garbage collection, street cleaning, basic education and health, either directly or by concession. To assist him or her in fulfilling such duties, the mayor appoints municipal secretaries.

Nonetheless, as better explained in **Part 1, Section 1.2** above, the Constitution grants exclusive authority to the federal government in regulating tenders and public contracting in general, which is binding on all other federative entities (that is, states, municipalities and the federal district). However, these federative entities may also enact their own public procurement laws, provided those laws do not conflict with the Public Procurement Act and related federal laws.

## **2 Do applicable public procurement rules authorize the implementation of an SIB scheme, i.e., funding social programs by means of an agreement between a government agency and an Intermediary, in which payment from the government would be entirely contingent on the organization achieving measurable and positive social outcomes?**

There is no identical correspondent to a SIB scheme under Brazilian legislation. Nevertheless, funding social programs usually occurs by means of Partnership Agreements entered into by the public administration and Public Interest Civil Society Organizations (OSCIPS). By means of the Partnership Agreement, the private entity will be able to receive financial resources and/or the public property needed for the execution of the activities, as per Article three of [LAW NO. 9.790/99](#).

The OSCIP status is granted by the Ministry of Justice. In order to qualify as an OSCIP, the entity must seek a public interest purpose that may not be for the benefit of or directed to a specific group of people. On the other hand, OSCIPs shall follow corporate governance rules and maintain an Audit Committee (which is not required of entities not qualified as such). Also, the status shall be renewed annually by a presentation of an annual activities' report and financial statements until the end of May. (Article. 5 of Law

No. 9.790/1999). In general terms, it could be acceptable to structure such a Partnership Agreement in which the Intermediary would be an OSCIP and would agree to present the government with social programs and to seek financing for it. It is important to bear in mind that the government will always have to choose the social program and contract directly with the executing entity under a Partnership Agreement. As previously presented in point 1.1.6, the government will make the final decision after assessing if the executing organization has achieved measurable, positive social outcomes.

### **3 How does the government of the jurisdiction contract social services? Is public procurement subject to special rules or would it be subject to general and commercial law rules? Is there flexibility in the performance and supervision of contracts by government?**

Public tenders consist of a series of acts that are governed by mandatory legal provisions, except where the law permits technical and administrative choices by the government in the interests of expediency. The Public Procurement Act sets forth rules for the acquisition of goods and rendering of services (please see item 1.1.2 above).

There are circumstances in which the government may contract with private parties without carrying out public tenders, the obligation to conduct tenders being waived. Situations in which a tender may be waived include those in which the government procures assets based upon the nature of the business, whether for lack of competition or due to the personal skills of the individual being hired (e.g., the issuance of an opinion by a famous scholar).

Tender waiver is also foreseen in cases in which it is not expedient for the government to perform public tenders, and includes, without limitation, cases where the object of the bid has low value, public disasters or disturbances, war, or other emergencies, amongst others.

On the other hand, a concession for public services is the usual legal instrument by which the government attributes the exercise of a public service to a private partner that agrees to provide it, for its own account and risk, in accordance with the conditions previously set forth in the concession contract. Concessions are subject to unilateral amendment by the granting authority, counterbalanced by a guarantee of the government to maintain contractual fairness and equilibrium. The concession is remunerated by the use of the service by the general public, through tariffs or fees charged directly to users.

A PPP is a mechanism by which the government contracts for an infrastructure project, along with the supply of the service related to it.

Important developments involving PPPs include two new types of concessions that can be entered into by PPP. The first is the sponsored concession; the private concessionaire is remunerated not only by the payment of fees by the users of the services supplied by the PPP, but also through preset payments from the public partner. The second is the administrative concession; the government is the direct or indirect beneficiary of the service that will be provided by the private partner. Therefore, remuneration is made

solely by the government. Another important innovation is the creation of a guarantee fund that underwrites the obligations of the public sector partner in PPP contracts and serves as a guarantee in the event of lawsuits and claims against the government.

PPPs are useful to the government, as they permit contracting for the construction, management, and supply of services with better payment methods. The government can structure PPPs when investments in key areas are needed, but public funds and/or public expertise are lacking. Moreover, with PPPs, a portion of the responsibility for the execution of the project is shared with the private partner.

There are three main limitations on the use of PPPs: (i) the amount of the contract can be no less than BRL20 million; (ii) the term of the contract can be no less than five years; and (iii) PPPs may not result in agreements with the sole purpose of contracting for labor, the supply and installation of equipment, or the performance of construction for public works projects.

All administrative contracts may be amended unilaterally subject to proper justification (please see **Section 1.6** above).

**4 May an Intermediary tender for both design and implementation stages or would there be impediments because of conflict of interests? Would it be possible to combine direct contracting or PPPs with public procurement and, thus, avoid the conflict of interests issue (i.e., Intermediary would either design or implement under a PPP or direct contract and, thus, be able to tender for the remaining stage.)?**

Under the discipline of the Public Procurement Act, parties that have participated in the design of the basic or executive project may not participate in the bidding. Nonetheless, such rule does not apply to concessions of public service, including PPPs (please see **Part 1, Section 1.2** above where it refers to PMIs). In a partnership agreement, ruled by [LAW NO. 9.790/1999](#), the organization can discuss with the government the design and structure of the public project that will be created by this organization if the government agrees to enter into a partnership agreement.

**5 Does annual budgeting apply? If so, are there legal mechanisms to ensure future payments? Can these mechanisms commit future administrations? Where the law does not readily allow for future payments, could trust structures or special vehicles be set up to make up for any shortfalls in the law?**

All governmental actions are ruled by budgetary laws, including those related to the payment of compensation concerning long term programs. Budgetary laws include the Multi-annual Plan, Budget Directives Law and Annual Budget Law. It is possible to have payments that are not only linked to the current year budget, but to the forecast of the next few years, provided that this condition is previously expressed in the Multi-annual

Plan (in a generic way), as well as indicated (with precise definition) in the Budget Laws of the next several years.

**6 What happens if a government entity does not execute the whole of its annual budget? Would there be any negative consequences for the entity? If so, would there be legal mechanisms to enable the “freezing” of budget funds?**

In the case of default by public administration, there is no special mechanism enabling the “freezing” of budget funds. If no guarantee of payment is established in the contract, all debts shall be demanded judicially and executed by the *precatório* regimen.

The Brazilian public entities (federal, states, federal district, municipals and public government entities) pay their debts originating from judicial condemnations through the so-called *precatórios*. For the issuance of a *precatório*, the judicial decision must be final and unappealable.

The payment of the *precatórios* must follow a chronological order of their presentation to the Brazilian Courts.

The *precatório* included in a specific Budget Law must be paid up to 31 December of the relevant year. Except if destined to pay alimony or consisting of low amounts, *precatórios* can be liquidated in up to 10 annual installments, and each installment must be paid up to 31 December of every year. Nonetheless, in the case of PPPs, it is possible to establish guarantees in favor of the private partner, avoiding the *precatórios* regimen.

## PART 3: INTERMEDIARY

**1 If the Intermediary carries out activities as a mere advisor, would the law require the Intermediary to set up a permanent presence in the jurisdiction?**

No, the Intermediary is not obliged to establish a permanent presence in Brazil in order to perform advisory services to Brazilian clients. Nevertheless, if these advisory services are connected with securities (private shares excluded), such Intermediary may be required to be duly registered as a securities consultant with CVM in accordance with CVM Rule No. 43 of 1985, which shall be performed exclusively by natural or legal persons residing in Brazil.

From a tax perspective, it is also more efficient to render advisory services established in Brazil than those established abroad.

**If the Intermediary is receiving and administering investors’ money, would the law require the Intermediary to set up a specific type of entity in the jurisdiction?**

The activity of administering investor’s money in financial and capital markets shall be performed exclusively by natural or legal persons residing in Brazil and duly qualified as securities portfolio managers with CVM in accordance with CVM Rule No. 306 of 1999.

## 2 What types of entities are available in the jurisdiction?

In Brazil, legal entities can be divided into civil and commercial entities. Commercial entities entail necessarily entrepreneurial activities, whereas civil entities pursue intellectual, scientific, literary or artistic activities not organized as an enterprise, pursuant to [ARTICLE 966 OF LAW NO. 10.406 OF 2002](#) (“[BRAZILIAN CIVIL CODE](#)”). In this respect, civil entities must be registered before the Notary Office of Civil Registry of Legal Entities and commercial entities must register with the competent Board of Trade.

Relevant entity types are:

### I – FOR-PROFIT ENTITIES

**CORPORATION (SOCIEDADE POR AÇÕES)** – A corporation is a form of commercial entity, regulated by [LAW NO. 6,404/76](#) (“[BRAZILIAN CORPORATE LAW](#)”), whose stock capital is divided into shares. Each shareholder is liable solely to the extent of its subscribed shares. Corporations can be privately held or publicly held.

Corporations entail a more costly structure than limited liability companies and have a more rigid set of regulatory obligations.

**LIMITED LIABILITY COMPANY (SOCIEDADE LIMITADA)** – Limited liability companies can be civil or commercial entities, depending on purpose. Limited liability companies are governed by the [BRAZILIAN CIVIL CODE \(ARTICLES 1.052 TO 1.087\)](#) and, in the case its articles of incorporation provide so, are subsidiarily governed by the [BRAZILIAN CORPORATE LAW](#).

The stock capital of such companies is divided into quotas and all quotaholders are jointly liable for the full payment of the face value of the quotas. Once the quotas are paid up in full, each quotaholder is liable, to the extent of the value of its quotas. Limited liability companies are managed by appointed managers of the quotaholders, which can be quotaholders or not. In general, limited liability companies are more flexible and less costly to manage than corporations.

### II – NON- FOR-PROFIT ENTITIES

**ASSOCIATION** – Associations are not-for-profit legal entities formed by a group of individuals with a common purpose. In this sense, an association must have at least two members in order to be incorporated.

The first measure to incorporate an association in Brazil is to draw up its bylaws. The [BRAZILIAN CIVIL CODE](#) establishes that the association’s bylaws must describe: (i) the name and institutional purpose of the association; (ii) requirements to admit, to dismiss and to exclude members; (iii) members’ rights and duties; (iv) sources of income of the association; (v) constitution and functioning of the administrative body; and (vi) conditions to the amendment of the bylaws and to the dissolution of the association.

Though the association’s bylaws can freely rule the aforementioned matters, the Brazilian Civil Code establishes restrictions with respect to the constitution and functioning of the administrative boards of the association. The members of an association may be foreign citizens represented by means of powers of

attorneys that have express and specific authority to act at the General Meeting.

**FOUNDATIONS** – Foundations may be defined as a collection of assets with a legal personality, and incorporated for religious, moral, cultural or philanthropic purposes. These are created by means of will or public writ, which shall specify its purpose, as well as the management structure and principles of the foundation. Foundations are normally managed by an administrative board.

**3 Assuming that the Intermediary will receive funding (either through equity or loans) and will use them for the advancement of social projects, could the law of the jurisdiction consider that the Intermediary is carrying out financial intermediation activities or any other sort of regulated activity?**

**ARTICLE 17 OF THE LAW NO. 4.595 OF 1964** defines financial institutions as private or public entities whose main or ancillary purpose is to collect, intermediate or invest funds of third parties or of its own, in foreign or national currency. Receiving foreign funding through equity or loans and using these funds for the advancement of social projects developed by the Intermediary should not be sufficient for the Intermediary to qualify as a financial institution.

**What thresholds apply (if any) for being considered a regulated entity (i.e., under financial regulations)?**

There are no thresholds applicable for an entity to be considered as a financial institution.

**4 Does the law of the jurisdiction set forth foreign exchange constraints or mechanisms for remitting money into the jurisdiction and converting it into local currency?**

Yes. The nonresident investor must execute a foreign exchange agreement with a financial institution duly authorized by BACEN to transfer currency in the exchange market and the remittance of funds to Brazil in certain cases must be registered with BACEN, as per our answer in **Part 1, Section 1.4** above.

**5 If the Intermediary requires bringing foreign personnel into the jurisdiction, please discuss briefly what types of visas/permits may be required.**

In general terms, obtaining an appropriate visa for foreigners is the first step to hiring a foreigner to work in Brazil. This is an administrative procedure that comes under the competence of the Ministry of Labour and Employment (“Ministry of Labour”). The Labour Visa request must be applied by the respective employer entity that which shall be duly set up in Brazil.

Once the Ministry of Labor approves the application for a Labour Visa, the entity must submit the authorisation to the approval of the Ministry of Foreign Affairs, which is responsible for registering the visa in the foreigner’s passport, allowing him/her to enter the country and remain in Brazil to work, after satisfying the various conditions under the immigration legislation.



There are two types of visa which allow foreigners to work in Brazil: a Temporary Visa and a Permanent Visa.

**TEMPORARY VISA FOR WORK PURPOSE** – This is granted to foreigners who come to Brazil intending to work for a Brazilian company/entity as an employee (i.e., having a formal employment relationship). The visa will be granted for up to 2 (two) years, may be extended for a further equal period and, later, converted into a Permanent Visa.

The Temporary Visa for Work Purposes is the principal visa that allows foreigners to work in Brazil. This visa may be obtained for several kinds of work and for different periods of permanence and must be submitted to the analysis of the Ministry of Labour.

The Brazilian company/entity must initiate the visa processing by making an application to the Office of the General Coordinator of Immigration of the Ministry of Labour. Once the visa is approved by the Ministry of Labour, the Ministry of Foreign Affairs will be informed and will send to the Brazilian Consulate the permission for the foreigner to come to Brazil to work.

One of the most important conditions for obtaining this type of visa is that the Brazilian company/entity must respect the ratio of Brazilian and foreign employees, which must be not less than 2/3 (two thirds) Brazilian employees and 1/3 (one third) foreign employees, both in terms of the value of the salaries paid and of the number of employees.

In this regard, the application submitted by the company/entity to the Ministry of Labour must include documents required by the legislation in force.

**PERMANENT VISA** – A Permanent Visa may be granted to foreigners who intend to come to Brazil to work for an indefinite period of time as an administrator, manager, director or executive with administrative powers in a Brazilian company.

In order to apply for this type of visa, the company/entity in Brazil must comply with the requirements of the Ministry of Labour and present evidence of the following:

1. The Brazilian company must prove that it has received an equity investment of not less than BRL600,000.00 (six hundred thousand reais) per foreign worker and that such investment has been duly registered with the BACEN.
2. The investment above may be reduced to BRL150,000.00 (one hundred and fifty thousand reais), also duly registered with the BACEN, if the company/entity presents a plan to hire at least ten Brazilian employees within a period of two (2) years after the company/entity is established or after the hiring of the executive.

In this regard, the application submitted by the company to the Ministry of Labour must include other documents required by the legislation in force.



### TEMPORARY VISA – BUSINESS TRIP

The Temporary Visa for a business trip is applicable to foreigners who come to Brazil for specific business purposes for a “short” period of time, without the intention to become resident in Brazil. With this visa, foreigners are not permitted to work in Brazil and may only participate in meetings, conventions, fairs and so on, without being remunerated for these activities.

The temporary visa for a business trip is normally issued for up to 90 days (but for certain citizens, such as those of Australia, Canada and India, the visa may be issued for up to five (5) years, due to an agreement between governments). This period may be extended for up to another 90 days, at the discretion of the Brazilian immigration authorities. The foreigner may apply for this visa directly to his/her local Brazilian Consulate where s/he lives.

**RECORDS/REGISTRATIONS IN BRAZIL** – A foreign worker who comes to work in Brazil will need to secure: (i) a Foreign Identification Card (**RNE**); (ii) a Labour and Social Security Card (**CTPS**); (iii) an Individual Taxpayers’ Identification Number (**CPF**); and (iv) the registration with the National Social Security Institute (**INSS**).

## **6 Assuming that the Intermediary has been already set up as an entity in the jurisdiction, please discuss briefly what types of visas/permits would be required for it to engage overseas personnel for work in the jurisdiction.**

Only a Brazilian company may apply for the processing of visa for foreign workers. That said, please see the answer on **Section 5** above.

## **7 Is there any requirement for Intermediary’s directors/officers in the Jurisdiction to be national or residents of the Jurisdiction?**

With respect to corporations (*sociedades anônimas*), officers and directors are not required to be Brazilian nationals. However, according to **SUBSECTION 2** and heading of **ARTICLE 146 OF LAW NO. 6,404 OF 1976**, officers must be resident in Brazil and directors may be resident abroad but are required to appoint an attorney-in-fact resident in Brazil.

With respect to limited liability companies (*sociedades limitadas*), officers are required to be resident in Brazil.

## PART 4: SERVICES PROVIDERS

### **1 Assuming that the Intermediary signs a contract with the government, would the law allow the Intermediary to freely choose and contract with the service provider? Would the contract with the government restrict the choice of service provider made by the Intermediary?**

Assuming that the Intermediary entered into a contract with Public Administration, the activity of the Intermediary will be limited to the provisions set forth in the contract or partnership agreement. The choice of the Service Provider, nonetheless, will always have to be made by the government.

### **2 Is there a substantial risk that services providers' personnel could be re-characterized as employees of the Intermediary? What mechanisms are available for reducing/managing this risk?**

The Brazilian Civil Code states that a corporate entity that is contracted to provide services to another company shall only be considered as a "Service Provider" only if such contracting of services is not subject to labour legislation or any other special law. "Service Providers" are professionals who provide services to the contracting entity with autonomy and if the essential elements of an employment relationship (habituality, subordination and exclusivity) are absent.

Furthermore, the services contracted must not be within the core activities ("Core activities" will generally mean those activities contemplated in the company's corporate objects in its Articles of Association/Incorporation) of the contracting entity (with exception to intellectual activities, which may be so contracted).

In Brazil, the contracting of outsourced services is governed by [PRECEDENT Nº 331 OF THE SUPERIOR LABOUR COURT](#).

As stated in the abovementioned Precedent nº 331, Brazilian labour case law only permits the outsourcing of services or independent contracting when the following requirements are observed:

- The outsourced activity must not be linked to the core activities of the contracting company/entity.
- There must not be an *intuitu personae* relationship between the service contractor (and/or its employees) and the Service Provider's employees.
- The outsourcing company (Service Provider) must be specialised in the services to be rendered.

Moreover, it is important to mention that contracting the services of a specific individual through a company is notoriously risky in the sense that, unless each of the conditions above specifically applies, this will almost certainly generate a labour law contingency.

**ALTERNATIVES TO MINIMIZE RISKS** – We make the following recommendations as means to minimize the labour risks:

- a) Establish an exclusive personal assignment in the services provision.
- b) The relationship must be devoid of direct subordination between provider and the entity, that is, the entity must not supervise nor issue direct orders to the Service Provider.
- c) The relationship must be devoid of any working hours control.
- d) The entity shall not refund for any of the provider's expenses.
- e) There shall be no payment of benefits to provider.
- f) Badge, work desk, working material, access to the entity's telecommunication systems, use of the principal's email address, and the like, shall not be granted to the Service Provider, given that he must have his own work structure.
- g) The employee's performance of the same activities is not recommended, as this is an acknowledgment by the entity that the activities must be performed by employees and are not subject to outsourcing.
- h) Documents, such as warnings, internal communications, and the like, shall not be issued to the Service Provider or the company.

The adoption of the measures above do not eliminate the risks completely, but these may serve as arguments to the entity's defence, in case of any future litigations.

**FRONT COVER PHOTO** Tightrope  
walkers perform above a canal in  
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