

## **Legal organizational forms of unions of entrepreneurs (business associations) in Ukraine**

Normally, an important factor to take into account when creating unions or associations of entrepreneurs (hereinafter – associations) is the choice of their legal and organizational form and potential consequences of such a choice. An ‘association’ implies, by definition, that it is made up of several persons as members. Therefore, the scope of possible legal forms of such an organization is limited to membership organizations.

As of January 2001, the following entities belong to members’ organizations under the effective legislation of Ukraine:

- registered non-government organizations;
- NGOs legalized via public notification;
- unions of enterprises;
- representative offices of foreign associations;
- unions of non-government organizations (associations).

The rights of entrepreneurs to enter into associations are guaranteed by laws of various levels and by court practices. International agreements ratified by the Supreme Rada are also considered to be legislative acts of Ukraine, so that the rest of the acting laws are not to interfere with guarantees accorded by such agreements. Sometimes complications spring up in legal definition of a person as an entrepreneur. Above all, according to the appropriate laws of Ukraine, enterprises (at least those that are not state owned) as legal entities are independent subjects of entrepreneurship (or entrepreneurs). Otherwise, all their shareholders or co-owners would also have to be defined as entrepreneurs. Secondly, for various reasons individual persons prefer not to register officially as entrepreneurs, even though periodically they sell goods or services at their own risk. However, as will be shown below, this does not abolish their right to join an association.

### **Constitution**

The Constitution of Ukraine holds several important guarantees for the activities of association. Article 36 proclaims the rights of citizens to create unions, including NGOs and professional associations.

Another important guarantee is the right proclaimed by Article 42 for every individual to engage in entrepreneurial activity that is not prohibited by law. It is a personal right that is to be protected against all attempts to block or limit the right of entrepreneurs to engage in business activities of their own choice and without discrimination on the part of governmental agencies and bodies of local self-government.

Of special importance is the right, confirmed recently by the Supreme Court of Ukraine, of every individual for a free choice of his/her representative or protector of his/her rights (Article 59). Thus, all entrepreneurs are free to protect their rights on their own, or to authorize somebody to do so, including those associations that they are members of.

The Constitution is the law of direct action, so these guarantees do not require additional grounds. On the contrary, it has to be proved that implementation of these rights is incompatible with other constitutional guarantees or infringes on the rights of others. One should also remember Article 19 of the Constitution that does not allow requiring any actions that are not founded on law.

### **International agreements and treaties**

Following are the principal international law acts regulating the activities of associations in Ukraine: the 1966 International Pact on economic, social and cultural rights (995-042); the 1950 European Convention on protection of human rights and fundamental freedoms (995-004, ratified by Ukraine in 1995); and Convention 87 of the International Labor Organization on association freedoms and protection of organization rights (993-125, ratified by Ukraine on 11 August 1956).

The Pact and the European Convention guarantee the right to form association, including trade unions, and this right can be limited only by law (not by an administrative body!) in the interests of national security and public order, or to protect the rights and freedoms of other persons.

Note should be made of a false but common belief that the guarantees accorded by this Convention are applicable only to natural persons, rather than legal entities. However, as seen from the title of the Convention, 'fundamental freedoms' are not limited by 'human rights' only, and many legal entities (for instance, editorial boards of printed media) have won their case in court on the basis of this Convention.

The right to form associations is still a relatively undeveloped institution in international law, but Convention 87 offers accurate norms concerning the contents and guarantees of this right applicable to associations.

Thus, Article 2 provides 'to all entrepreneurs, without any preference, the right to establish organizations of their own choice, without prior permission, and also the right to join such organizations on the only condition of compliance with the charter of these organizations'.

Article 3 guarantees the right to freely develop charters and administrative rules of associations, to freely choose their representatives, to manage their staff and organize their activities, as well as to develop their action program. The article also obliges participating states to refrain from any limitation of these rights or from any interference that hinders exercising these rights.

Article 4 forbids disbanding or temporary closure of an entrepreneurs' association by administrative means.

Article 5 proclaims the right of entrepreneurs' associations to form federations and confederations, and to join them, as well as the right of every association of this kind to become member of an international entrepreneurs' association.

Article 6 indicates that obtaining of the legal entity status by such organizations cannot be limited by requirements that contradict the contents of Articles 2, 3 and 4.

Article 8 requires that national legislation does not interfere with or violate these guarantees.

Since the Convention treats of “organizations of the working people and entrepreneurs”, the status of associations should be defined as having equal rights with trade unions.

### **Special laws**

Even though associations often act as enterprises or unions of entrepreneurs, their status of not-for-profit organizations is defined by such major legislative acts as the Law of Ukraine on Profit Tax of Enterprises (334/94), the Law on Enterprises (887-XII), and the Law on Citizens’ Associations (2460-XII).

Membership in associations of enterprises is not an entrepreneurial activity in itself; therefore it can be consistent with “other associations of enterprises on the territorial, industrial or some other basis” whose registration is to be approved by the Antimonopoly Committee (887-XII, Art. 3, part 1).

Associations of this kind, if they only represent the interests of their members, get passive income or charge one-off or periodical dues from their participants, are recognized as not-for-profit organizations. Law 334/94 (item 7.11.1, paragraph “d”) describes not-for-profit organizations (code 0012) as organizations, such as unions, associations and other legal entities’ organizations created to represent the interests of their founders that are funded exclusively at the expense of membership dues of their founders and do not engage in the principal activities, except for getting passive income.

Besides, according to item 7.11.6 of this law, tax-free are earnings of not-for-profit organizations enumerated in item 7.11.1, paragraph “d”, in the form of one-off or periodical dues by founders and members, passive income (namely, royalties, interests, dividends, insurance payments, - all of these income items are specified by Law 334/94 and will be discussed later).

### **Administrative acts**

As a rule, the main constraint in establishing an association of enterprises is the need to obtain permission by the Antimonopoly Committee (887-XII, Art. 3 part 1). As will be shown later, this permission is not necessary for associations that do not engage in business operations, but only represent their members and protect their interests.

Another possible obstacle can be requirements of legal authorities (law enforcement agencies) concerning, for example, registration of entrepreneurs’ associations whose membership includes both individuals and legal entities. This 1992 law does not offer a conclusive definition legal entities participating in associations of individuals: legal entities as collective members can be represented by “work collective”. Firstly, this runs counter to the recognized principle of a free right to join and leave such associations (membership is approved or rejected by the majority of votes). Secondly,

collective membership of the work collective in an association can lead to a direct conflict of interests: an enterprise as subject of entrepreneurial activities is to be represented by a group that has been traditionally considered as employees. In this case, it seems expedient to add a phrase in the association's charter that proved useful in the past: "Members of the association can be persons registered as subjects of entrepreneurial activities in (the given industry) and/or on (the given territory) or in (the given region)".

### **Judicial practice**

An important court ruling on the issues of association activity guarantees is the ruling of the Constitutional Court of Ukraine on 18 October 2000 #11-pn/2000 (case 1-36/2000) concerning compatibility with the Constitution of Ukraine of articles 8, 11 and 16 of the "Law of Ukraine on trade unions, their rights and activity guarantees". Note should be made of the following components of this ruling:

Firstly, the list of interests of association members to be protected has not been officially determined, since under Article 36 (part 3) of the Constitution, all citizens' associations are legally equal. This list is contingent upon authorities assigned to the given association by its members or by other associations.

Secondly, the right has been confirmed to create an association on the basis of a free will of its members (regional, territorial or industry characteristics are not obligatory) as well as absence of constraints for employees of an enterprise to form their association.

Thirdly, requirements that are impossible to implement (e.g., a ban on creation of a new association on similar grounds if similar associations have already been established) and a cap on the number of members have been recognized as infringement on constitutional rights of citizens.

Fourthly, unconstitutional have been declared all requirements that make the launch of an association contingent upon the date of its registration with appropriate governmental agencies, which is equivalent to a preliminary permission for its activity.

Fifthly, the right has been guaranteed for a free creation of national federations or confederations and other alliances of associations.

### **Draft laws**

Although there is no separate law or even draft law in Ukraine on entrepreneurs' associations yet, the above decision of the Constitutional Court allows to avoid many mistakes caused by lack of attention to the specifics of such associations. At the same time, it should be remembered that the attempts to limit such draft laws by 'employers' associations' only are certain to narrow the right for creation of associations businessmen in general, since most of them work as individual entrepreneurs and, in any case, do not employ others regularly.

Of special significance is the fact that the framework draft law approved in the first reading in October 2000 on non-entrepreneurial organizations (the term defines non-

profit, or non-government organizations in the draft Civil code) does not impose any norms concerning the establishment and operations of associations and trade unions. This Conforms to the European practice of regulating by special laws such associations as the charge and political parties.

Thus, we can conclude that the Constitution of Ukraine, the international agreements and the decisions of the Constitutional Court concerning associations do not introduce as many constraints as under the previous administrative practice to the creation and operations of associations of entrepreneurs that do not engaged in business activities. More detailed analysis of these legal guarantees will serve as a reliable tool to protect the rights of entrepreneurs and their associations.

What are the basic differences of specific legal forms of associations?

The law does not set a minimum cap on the number of participants (founders and members) of associations. However, a nation-wide association cannot be registered unless it has offices in the majority of regions (that is, at least in 14 oblasts or cities of Live and Sevastopil).

There are certain constraints on membership in enterprises' associations: state-owned enterprises, coal and power sector enterprises cannot join such associations (887-XII, Art. 3).

In contradistinction to participation in the charter capital or other ownership rights of enterprises and their associations, the rights of association members cannot be alienated. This is due to the fact that associations protect personal non-property rights of participants; this is why their identity is a fundamental trait of participation in the given association.

In contrast to associations of enterprises, NGOs are not currently subject of foreclosure procedures on the grounds of bankruptcy and decisions of the court of arbitration. Hence, it only within the jurisdiction of courts of law to stop or suspend the operations of NGOs on the proposal of the prosecutor's office or other juridical body in case of violations of article 37 of the Constitution and of article 4 of the Law on the associations of citizens.

### **Associations without the status of a legal entity**

Such associations include simple partnerships, ad hoc committees, and offices of registered associations. These can be made legal without payment of registration duty, even though many problems emerge in managing such associations. Ukraine is one of the states that recognize partnerships as legal entities or as associations of legal entities. Moreover, the effective Civil Code even prohibits joint activity and joint ownership of natural persons and legal entities.

Time-consuming registration and reporting procedures discourage many potentially active members of associations, particularly private businessmen, from going through official channels. It is assumed that most of acting associations operate as partnerships and do not care about registration.

Besides, registered associations are subject of control by numerous governmental agencies (tax administrations, statistics, registration and licensing agencies, local self-government bodies, prosecutor's office, fire hazard inspectorate etc.). As a result of fines and duties levied by these agencies, many NGOs in Ukraine have to close their operations while others are often unable to dispose of a significant portion of their funds and to offer services to their members.

The most useful approach under such circumstances seems to be conformity with norms regulating the operations of registered associations and the relations of joint activity (partnerships) that will satisfy the needs of unofficial associations, as is foreseen by the draft of a new Civil Code:

- two or more partners will freely define the goals and the contents of a written agreement that should not run counter to the effective laws or allow payment of dividends; (In Ukraine, dividends obtained as a result of joint activities without creation of a legal entity are subject of tax as dividends of common enterprises);
- partners may offer their funds, pieces of property or ownership rights as their contribution;
- real estate and other property that is subject of obligatory state registration can be attributable to one or several partners, but not to all of the partners;
- the agreement can specify the procedure for compensation of partners' expenses incurred in the interests of their partnership;
- each of the partners has the right to act on behalf of the association, unless the agreement authorizes several or all partners to act jointly (according to a written agreement or on power of attorney provided by the rest of the partners);
- partners cannot refer to lack of authority by a certain partner in his dealings with third parties on behalf of the partnership, unless they can prove his fraud or that the third parties have been aware or should have been aware of this lack of authority;
- partners will incur costs or losses proportionately to their contributions;
- partners will have access to the joint activity documentation;
- the agreement can provide for continuation of the activities of the association despite the termination of membership of one of the partners;
- partners are subject of joint and several liability for losses incurred and for third person liability in case of liquidation of the association;
- each of the partners is free to terminate membership in the association, but is liable for possible losses incurred by the association over a certain period.

## **Representative offices of foreign associations**

A special category is made up of representative offices of associations legalized in foreign countries (particularly where the terms are easier for legal entities to create an association). These offices have the status of non-residents, if they do not engage in other activities over and above representing the interests of the association and those of its members. They may not pay profit tax in Ukraine and will have fewer constraints in terms of currency regulation. The disadvantage for such representative offices is the need to pay a higher registration duty, the existence of the so-called offshore zones list that may lead to retained profit, and the need to carry out certain expenses in the country where the association has been legalized. However, these disadvantages will disappear once Ukrainian associations or their alliances have joined acting foreign or international associations that pay the operating expenses.

Thus, the analysis of the effective legislation and the current judicial practice in Ukraine indicates that the choice of a representative of their rights by entrepreneurs depends primarily on appropriate capabilities of the association, whatever its legal status may be, and on what sort of earnings the association may wish to have (membership dues are not tax-free for all types of associations). It seems to be possible to resolve the issue of membership of entrepreneurs as natural persons and legal entities in one association under the terms of current legislation.