



USAID
ОТ АМЕРИКАНСКОГО НАРОДА

ICNL | LLC

**ENTREPRENEURIAL ACTIVITY
OF NONCOMMERCIAL ORGANIZATIONS
IN THE KYRGYZ REPUBLIC**

Bishkek 2012

ENTREPRENEURIAL ACTIVITY OF NONCOMMERCIAL ORGANIZATIONS IN THE KYRGYZ REPUBLIC

Noncommercial organizations (NCOs) are usually engaged in performing important social services and depend on donations and grants to support this activity. However, many NCOs are unaware that the law also permits them to engage in the sale of goods or services and make profit from this activity, subject to certain constraints. This brochure describes the laws of the Kyrgyz Republic that regulate so-called “entrepreneurial activity” or “economic activity” carried out by an NCO.

Engaging in economic activity may subject an NCO to a complicated regime of licensing and taxation. NCOs are urged to seek competent legal, accounting and other professional advice before and while engaging in such activity.

Right of noncommercial organizations to carry out entrepreneurial or economic activity

Article 12 of the Law of the Kyrgyz Republic “On noncommercial organizations” establishes the basic rule for NCOs who wish to engage in economic activity:

“A noncommercial organization shall have a right to carry out economic activity, including production activity, without distribution of received profit among founders, members, officials, other employees and members of management bodies. This activity could include in itself production and sale of goods, accomplishment of works, rendering of services for compensation and other kinds of entrepreneurial activity, if they do not contradict the goals and tasks of the organization.”

The Civil Code of the Kyrgyz Republic (further “Civil Code”) defines an entrepreneurial activity as “independent activity, carried out at one’s own risk, directed at receiving profit”.¹ The Tax Code of the Kyrgyz Republic (further “Tax Code”) refers to the Civil Code in defining the notion “entrepreneurial activity”. The Tax Code also defines the broader term, “economic activity,” to mean entrepreneurial activity and “other activity,” which includes such things as investment of money in banks and in equity capital of other companies.² This brochure will focus on entrepreneurial activity.

Forms of carrying out entrepreneurial activity by an NCO

Entrepreneurial activity of NCO can be carried out:

- (1) by the organizations itself, or
- (2) through creation of affiliated commercial organizations³. In this case the affiliated commercial organization transfers received profit to the founder, i.e. NCO, which in its turn directs these funds for achievement of its goals.

¹ Article 1 (4) of the Civil Code as of May 8, 1996 # 15

² Paragraph 3 of article 21 of the Tax Code lists types of “other activity”: (1) carrying out activity pursuant to the labor legislation of the Kyrgyz Republic; (2) investment of money in banks; (3) acquisition, transfer or sale of securities, an individual’s or legal entity’s share in equity capital; (4) receipt of any payments related to an individual’s or legal entity’s share in equity capital; (5) receipt of penalties, fines, compensation for moral damage; (6) receipt of insurance sum (compensation) on insurance contracts; and (7) other activity which is not considered as entrepreneurial activity.

³ Article 150 of the Civil Code as of May 8, 1996 # 15

This brochure deals with clarification of provisions of legislation of Kyrgyz Republic regulating to entrepreneurial activity carried out by an NCO itself, as well as through creation of affiliated commercial organizations.

Carrying out entrepreneurial activity by an NCO itself

Any NCO carrying out entrepreneurial activity must adhere to the following three conditions: (1) deriving of profit shall not be the major goal of creation of the organization⁴, (2) received profit shall not be distributed among participants, founders or members,⁵ and (3) entrepreneurial activity shall not contradict the goals and tasks of the NCO.⁶ For example, a public association which has the goal of reducing smoking would have no right to sell tobacco products, as the sale of tobacco products contradicts the goal of creation of this organization.

Accounting requirements in the implementation of NCO entrepreneurial activity

In case when NCO carries out only entrepreneurial activity, for instance, conducts paid seminars, and there is no income from noncommercial activity (e.g. grants), the NCO keeps accounting in the same order as commercial organization. Necessary to have in mind that all expenditures that such organization makes for statutory noncommercial activity and not related to deriving of profit may be performed only from profit of an NCO after payment of taxes.

More common is situation when NCOs are engaged at once in statutory noncommercial and commercial activities and in parallel have incomes exempt from profit tax (e.g. grants, donations) and subject to profit tax (sales revenue). In these cases according to the requirements of legislation of Kyrgyz Republic on accounting an NCO must maintain two sets of accounting books: one set for noncommercial activity and a separate set for entrepreneurial activities in accordance with the legislation of the Kyrgyz Republic on accounting. It is necessary to keep separate records for each type of tax:

- Income tax;
- VAT;
- Sales tax;
- Property tax.

Certain types of revenue, such as grants, donations or membership fees, received by an NCO from carrying out its statutory noncommercial activities are not subject to profit tax so long as all the revenue is expended in carrying out those activities. Advisable that the accounting book that records taxable income and expenditure of statutory noncommercial activity, as well as the performance report of the NCO that is filed with tax authorities, as the final result have a zero balance, demonstrating that all the income was spent in accordance with the organization's statutory goals. In case if an NCO will not spend all financial resources received from noncommercial activity, remaining balance will be taxable income. Moreover, it's necessary to show by document all expenditures related to noncommercial statutory activity and ensure that expenditures were really related to statutory purposes of an NCO. Otherwise tax authority may refuse to allow costs that were not documented or were not incurred in accordance with the NCO's statutory purposes. Such expenditures will be considered as taxable income for NCO and NCO will have to pay profit tax on the sum of not allowed costs.

⁴ Article 2 of the Law of the Kyrgyz Republic "On noncommercial organizations" as of October 15, 1999 # 111

⁵ Article 12 of the Law of the Kyrgyz Republic "On noncommercial organizations" as of October 15, 1999 # 111

⁶ See above

NCO with property or expenses that are used for both noncommercial and entrepreneurial activity can have additional problems. The Kyrgyz accounting rules propose to use method of proportional partition of costs of incomes from commercial and noncommercial activities. This method consists in that costs related to acquisition of income (exempt from and liable to profit tax) are apportioned in proportion to earned income (taxable and nontaxable) to total income of organization.

If an organization carries out only one type of activity (e.g. noncommercial activity using grant or commercial activity), in this case there is no need in maintaining separate accounting. Accounting is kept according to requirements of legislation of Kyrgyz Republic and International Financial Reporting Standards (IFRS).

If an organization (NCO) in parallel carries out both noncommercial (implements grant agreement) and commercial activities, in this case analytical accounting is maintained separately in order that financial information is open and transparent during donor audits, inspections by auditors and tax authorities of the country. For this purpose it is necessary to work out working mechanisms for maintaining accounting for particular organization taking into account specificity of activities of this organization.

For instance, if organization within the accounting period received grant equivalent to 5000 USD (nontaxable income) and income from entrepreneurial activity (conducted paid seminar) equivalent to 500 USD (taxable income), then office maintenance charges (rent) , where the seminars took place and the NCO's staff is allocated should be apportioned as follows: 91% - noncommercial activity and 9% - entrepreneurial activity. In the abovementioned example taxable income earned from entrepreneurial activity can be decreased by sum of office maintenance charges (rent) at the rate of 9% from total expenditures for office maintenance. Necessary to have in mind that according to proportional method, for example, the head of NCO can expand a lot of time for organization and conducting entrepreneurial activity, but if the income from such activity will be insignificant compared to incomes from grants, then the head of NCO will not be able to exempt from income from entrepreneurial activity his time spent in fact, but only minor part of it (proportionally to income from entrepreneurial activity to total income of organization). Moreover, in practice there arise a lot of questions on how to apportion and show in document such costs. Some organizations in order to avoid problems with tax authorities do not exempt such costs from income gained from entrepreneurial activity.

In any case, for an NCO earning income from both noncommercial and entrepreneurial activities it's advisable to seek advice from a highly qualified accountant and tax adviser with experience in dealing with the tax authorities in order to fully understand the legal requirements and risks involved.

An NCO that carries out entrepreneurial activity through the establishment of a separate subsidiary may find it easier to keep the separate books and records required and may be less likely to have its income and expenses challenged by tax authorities. However, the problem is not entirely eliminated if the two entities share staff, office space or other expenses, because the sharing arrangement could still be subject to challenge under affiliated transaction rules (Articles 119-121 of the Tax Code).

Regulatory considerations of Entrepreneurial Activity of Charitable Organizations

NCOs created in such legal organizational forms as public associations, foundations and institutions have a right voluntarily to acquire the status of charitable organization pursuant to the law of the Kyrgyz Republic "On philanthropy and charitable activity." The status of charitable organization grants significant tax benefits to the NCO when carrying out

entrepreneurial activity, but at the same time, obliges it to correspond to stricter requirements in comparison with ordinary NCOs.

The Tax Code defines “**charitable organization**”⁷ as follows—“a noncommercial organization: (a) created and carrying out charitable activity in compliance with the legislation of the Kyrgyz Republic on noncommercial organizations and charitable activity, such as, but not limited to social support and protection of citizens, including improvement of the financial condition of low-income people, social rehabilitation of unemployed, disabled, and other persons, who due to their physical and/or intellectual characteristics or other circumstances are not able independently to exercise their rights and legal interests⁸; (b) not participating in the production and/or sale of excise goods or gambling business; and (c) not participating in the support of political parties or election campaigns.” The term “charitable activity” is defined as “volunteer activity of individuals and legal entities on unselfish (gratuitous or on preferential conditions) transfer of property, including money, unselfish performance of works, rendering services, and other support to citizens and legal entities”⁹.

In carrying out entrepreneurial activity charitable organization must meet all conditions applicable to NCOs generally. In addition the carried out activity of charitable organization must **correspond to the goals of creation of the organization**¹⁰. For example, a charitable organization with the goal of providing support to the disabled could open a shop to sell specialized goods intended for the disabled (for example, wheelchairs, prosthetic devices etc.). But if the charitable organization were to carry out other types of entrepreneurial activity, for example, to create a sewing workshop or sell other goods, that do not correspond to the goals of its creation, then it could lose its status as a charitable organization and be unable to qualify for tax benefits granted to charitable organizations.

In such a manner, the right of a charitable organization to carry out entrepreneurial activity is narrower in comparison with ordinary NCOs. But in contrast to NCOs whose incomes from entrepreneurial activities are liable to profit tax, incomes from permitted entrepreneurial activities of charitable organizations are exempt from profit tax.

7 Part 2 of article 153 of the Tax Code

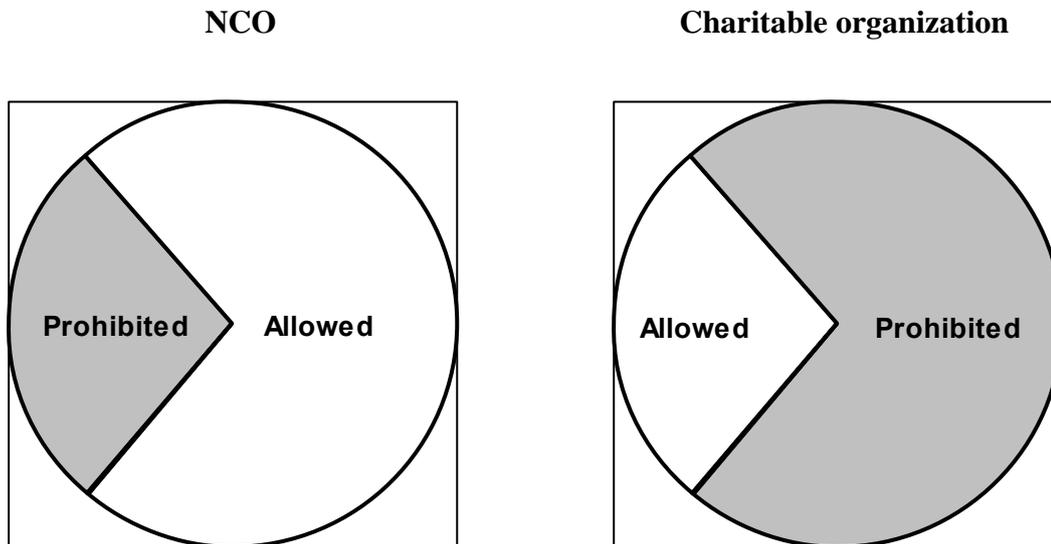
8 The full list of charitable activities is stipulated in article 1 of the Law of the Kyrgyz Republic “On philanthropy and charitable activity” as of November 6, 1999 # 119

⁹ See above

¹⁰ Article 7 of the Law of the Kyrgyz Republic “On philanthropy and charitable activity” as of November 6, 1999 # 119

Entrepreneurial activity

Comparison of rights of NCO and Charitable organization to carry out entrepreneurial activity (Comparison of limits of allowed entrepreneurial activity for NCO and Charitable organization)



Licensing requirements

Some types of entrepreneurial activity can be carried out on the territory of the Kyrgyz Republic only after receiving a **special permission (license)**. The procedures for obtaining a license are regulated by the Law of the Kyrgyz Republic “On Licensing”¹¹. Issuance of licenses to the receiver (licensee) is carried out by ministries, agencies and other state bodies (licensors), determined by the legislation of the Kyrgyz Republic.

Pursuant to the legislation of the Kyrgyz Republic 29 types of activity are subject to licensing, including production and sale of pharmaceuticals, vaccines and sera, medicines and medical technology, urban construction, managing a nongovernmental pension fund, postal, electrical communication, data transmission, television and radio broadcasting, education activity except (for) state-owned educational schools, waste recycling, allocation, destruction and burial of toxic materials and substances, legal practice and other specified activity¹².

Licenses are characterized by subject and volume of activity, duration, territorial sphere of effect, and transferability. And NCO wishing to engage in entrepreneurial activity should check carefully whether such activity would require a license.

Taxes and Social Payments to the Social Fund

¹¹ Law of the Kyrgyz Republic “On licensing” as of March 3, 1997 (with last amendments as of October 13, 2009 # 270)

¹² The full list of activities subject to licensing is listed in the Law of the Kyrgyz Republic “On licensing” as of March 3, 1997 (with last amendments as of October 13, 2009 # 270)

All NCOs are subject to taxes and social payments to the Social Fund.

Profit Tax. Tax legislation, as a rule, does not exempt NCOs from profit tax. According to Article 189 of the Tax Code, following are not subject to the profit tax:

“3) received with the NCO:

- a) Membership and entrance fees;
- b) Humanitarian aid and grants provided they are used for statutory purposes;
- c) The cost of the assets received free of charge provided that they are used for statutory purposes;
- d) Payment for services of technical maintenance of apartment houses and service of buildings and constructions thereof;
- e) Payment for services of irrigation water delivery within the statutory activities provided by water users organizations for their members”

If there is taxable profit, then tax is levied at the rate of 10%. The profit of communities of disabled persons of groups I and II are free from taxation, as well as enterprises where disabled, blind and deaf persons consist of not less than 50% of the number of employees and their combined salaries must comprise not less than 50% of all salaries.¹³ The list of enterprises qualifying for this exemption is determined by the Government of the Kyrgyz Republic (see Attachment A).

The profit of charitable organizations is also exempt from profit tax.¹⁴

Sales Tax. Sales tax is an indirect tax applied at the point of sale. The sales tax is included in the price of goods, services and works if the sales contract stipulates that the price includes all applicable indirect taxes. The sales tax rate varies, depending on whether the sale of goods, works and services is subject to VAT or not and, in the case of goods, whether they are acquired for trading activity, which means “acquiring goods for resale”¹⁵.

In the case of goods, works and services that are either subject to VAT or VAT-exempt, the rate is 1 % on trading activity and 2 % on any other activity. If the sale of goods, works and services is made by a person who is not a registered VAT -payer and is not VAT-exempt, the sales tax rate is 2 % on trading activity and 3 % on any other activity, correspondingly.

The sale of goods, accomplishment of works and rendering of services by NCOs are exempt from VAT, so long as the sale price does not exceed the cost, and the sale is either:

- 1) for social welfare and the protection of children or indigent citizens of advanced age;
- or
- 2) in the sphere of education, medicine, science, culture, and sports.

Charitable organizations are fully exempt from sales tax on any activity, including entrepreneurial activity. However, following two requirements should not be omitted:

- 1) “Charitable organization” should correspond to requirements of legislation of the Kyrgyz Republic on noncommercial and charitable organizations;

¹³ Part 2 of Article 212 of the Tax Code

¹⁴ Part 1 of Article 212 of the Tax Code

¹⁵ Article 319 of the Tax Code.

- 2) Income must not exceed the costs: “Charitable activity” – voluntary activity of an individual and/or legal entity, aimed at realizing the charitable goals of the legislation of the Kyrgyz Republic on charitable activities regarding transfer of assets, delivery of services, and performance of work to individuals and legal entities under disinterested base (grant or preferential terms) or for fee not exceeding the factual costs incurred.

Employee Income Taxes and Payments to the Social Fund. All commercial organizations and NCOs who have employees are obliged to:

- 1) Pay, out of their own funds, insurance fees to the Social Fund in the amount of 17.25% of all payments accrued for the benefit of hired workers (employer’s portion); and
- 2) Deduct from the accrued salary of workers and transfer:
 - To the Social Fund, insurance fees in the amount of 10% of the employee’s accrued salary (employee’s portion);
 - To the state budget the employee’s income tax in the amount of 10% of the worker’s accrued salary after certain deductions.

Employees of NCOs are subject to taxation on income according to general rules. They pay income tax on their salary regardless of whether the source of funds is taxable or tax-exempt to the NCO-employer. The payment of income tax is the responsibility of the organization-employer that pays the salary. From the employee’s gross salary the organization-employer first deducts payments to the Social Fund, as well as standard deductions permitted to individuals. The remaining sum is taxed at the above-mentioned rate of 10%.

Value Added Tax (VAT). In general, NCOs are not exempt from VAT. However, an organization is required to register as a VAT payer, compute and pay the tax, and file monthly reports only when the volume of taxable goods, works and services sold or otherwise transferred by the NCO (except for exempted supplies) exceeds the registration threshold, which today is KGS 4 million over a period of 12 successive months.

According to Article 224 of the Tax Code, taxable supplies do not include VAT exempt supplies and supplies not subject to VAT.

According to Article 251 of the Tax Code, supplies of services by charitable organizations within charitable purposes in line with the legislation of the Kyrgyz Republic on philanthropy and charitable activity are the VAT exempt supplies.

According to Article 252 of the Tax Code, supplies carried out by noncommercial organizations for payment not exceeding expenses of these supplies are considered VAT exempt, if these supplies are:

- 1) For social welfare and children protection or indigent citizens of advanced age;
- 2) In education, medicine, science, culture, and sports spheres.

VAT shall be applied only in case supplies do not fall under these requirements.

If the registration threshold is reached, an organization must, during the month following, register with the tax authorities as VAT payer and pay this tax and submit reports monthly until the organization ceases acquiring taxable supplies and annuls its registration. The VAT rate is 12 percent on all taxable supplies and taxable imports.

VAT is levied in the following way. If goods, works and services are acquired from a VAT payer, then the taxable amount on acquisition is indicated separately from the final acquisition price in the invoice. While preparing a report, a taxpayer must calculate total VAT on goods and services acquired by taxpayer during the month, and then deduct paid and payable VAT on supplies for the month. If VAT on supplies exceeds VAT on acquisitions, then the difference is paid to the state budget. If the difference is negative, the negative amount can be used to reduce taxes owed in future periods.

Excise Tax. NCOs are not exempt from excise tax on excise goods they may produce.¹⁶ However, most NCOs will not be interested in producing such goods. Charitable organizations dealing with such types of activity lose their status, even if they are guided by good goals. There are no exemptions for NCOs from this tax.

Land Tax. The land tax is levied on land owners or land users. The land tax is applied on agricultural lands and lands of human settlement, industry, transportation, communication, defense, nature preservation, health-improvement, recreation and forest resources. Tax rates depend on location and classification of lands (their purpose of use). Lands belonging to religious organizations, organizations of disabled persons, war participants and equivalent categories of people and lands of communities of blind and deaf people are exempt from this tax¹⁷.

Property Tax. The property tax is imposed on immovable improved property, which could be in state, municipal or private ownership. The property tax is different from the land tax, which is applied only to that portion of land without improvements. The tax is imposed on the owner of the property, but in case the owner cannot be determined (for example, in the absence of registration of ownership rights on the property), the tax will be imposed on the organization or individual using the property. Government-owned property given to private use is also subject to the tax, paid by the user.

According to the Tax Code, property is divided into four groups: (1) residential property; (2) permanent property used for carrying out economic activity; (3) temporary structures (such as kiosks) used for carrying out economic activity; and (4) transportation vehicle, including self-propelled machines and mechanisms.

The tax rate for property used for economic activity is 0.8 percent of the taxable value. If the property is not used for carrying out an economic activity, the rate is set much lower—only 0.35 percent of the taxable value. The tax rate for transportation vehicle, including self-propelled machines and mechanisms depends on type of the engine, engine displacement, useful life of the vehicle and other specifications.

The status of being a noncommercial organization does not by itself exempt the organization from the property tax. However, the property of an NCO intended for use as its office and not used for carrying out an economic activity does not fall under any abovementioned groups. Therefore, such property should not be taxed. In practice tax authorities will demand to pay this tax. If any part of the property is rented or used for other forms of economic activity, the whole property is subject to the higher 0.8 percent rate. In other words, there is no mechanism to apportion the property into two parts, which could be taxed at different rates.

¹⁶ Excise goods are listed in Article 285 of the Tax Code and include alcoholic drinks, tobacco products, combusive-lubricating materials and some other luxury goods.

¹⁷ Paragraph 5 of Article 343 of the Tax Code

The following categories of immovable property are exempt from the property tax:

(1) immovable property in groups 1 and 2 belonging to communities of disabled people, and of blind and deaf people, where such people comprise not less than 50 percent of the whole staff of the organization, and the aggregate salaries of such people comprises not less than 50 percent of the entire payroll of the organization. The enterprises entitled to this exemption are determined by the Government of the Kyrgyz Republic;

(2) immovable property in group 2 belonging to organizations carrying out activity in the spheres of culture, education, public health, sports, social welfare and protection of children or poor people of advanced age.¹⁸

The tax is payable each quarter before the 20th day of the third month of the quarter, in equal portions over the course of the year. If the amount of land tax paid on the land on which the immovable property is situated is less than the amount of the property tax for that immovable property, the land tax will not have to be paid. If the land tax is higher than the property tax, then the entire land tax is paid, but the taxpayer will not have to pay the property tax. The total tax paid by the taxpayer for land and the immovable property situated on the land is therefore the higher of the property tax or the land tax.

Creation of affiliated commercial organizations

An NCO can establish an affiliated commercial organization and receive income from its activity.

A commercial organization is considered to be affiliated with an NCO if the NCO, “due to dominant participation in its capital, or pursuant to an agreement concluded between them, or in some other way has an opportunity to determine decisions adopted by this organization”¹⁹.

An affiliated organization can be established in organizational and legal forms stipulated by the legislation of the Kyrgyz Republic (for example, Limited Liability Company (LLC), Subsidiary Liability Company (SLC), Joint Stock Company (JSC) etc.). Limitations on carrying out entrepreneurial activity are applied only to NCOs and are not applied to affiliated organization of NCOs, and its income may be distributed to the NCO that established this organization in full or in part.

Registration. The Law of the Kyrgyz Republic “On state registration of legal entities” established a “one-stop” system of registration, pursuant to which an applicant submits a registration application to one state body, and all other necessary transactions are carried out by the state bodies themselves through information exchange.

The following documents should be submitted for registration:

- (i) registration application;
- (ii) decision of founder(s) on creation of the legal entity;
- (iii) other documents, stipulated by the Law of the Kyrgyz Republic “On state registration of legal entities”.

If the specialist of the registration body does not identify any shortcomings in the documents, then pursuant to the “one stop” principle state registration is carried out simultaneously with tax

¹⁸ Article 330 of the Tax Code

¹⁹ Article 150 of the Civil Code as of May 8, 1996 # 15

bodies, statistics bodies and Social Fund, and a certificate of state registration with registration number, taxpayer's identification number and code of republican classifier of enterprises and organizations will be issued within three business days after filing the application (for commercial legal entities, as well as affiliated commercial organizations). The applicant is considered as legal entity upon issuance of order of registration. After the entity is registered, it must order a seal and open a bank account in order to conduct business.

The fee for state registration of legal entities (including NCOs) is determined pursuant to the legislation. Currently fees are set at the following rates: state registration – 224 Kyrgyz soms; registration of activity termination – 192 Kyrgyz soms; issuance of certificate's duplicate and delivery of information from state registry – 64 Kyrgyz soms. Applicants shall pay 11 soms for the blank of the state registration certificate.

An affiliated commercial organization is subject to the same taxation and licensing rules applicable to ordinary commercial organizations.

Attachment A

Approved
by Order of the Government
of the Kyrgyz Republic
as of December 30, 2008 # 736

List

of enterprises of communities of disabled of groups I and II, as well as
of the Kyrgyz community of blind and deaf people where disabled,
blind and deaf persons consist of not less than 50%
of the whole staff of the organization and the aggregate salaries
comprises not less than 50 percent of the entire payroll of the organization,
which are exempt from profit tax

1. Bishkek field enterprise # 1 of the Kyrgyz Community of Blind and Deaf People
2. Bishkek field enterprise # 2 of the Kyrgyz Community of Blind and Deaf People
3. Bishkek field enterprise # 3 of the Kyrgyz Community of Blind and Deaf People
4. "Karek" Limited Liability Company of the Kyrgyz Community of Blind and Deaf People
5. Sadov field enterprise of the Kyrgyz Community of Blind and Deaf People
6. Kant field enterprise of the Kyrgyz Community of Blind and Deaf People
7. Chui-Tokmok field enterprise of the Kyrgyz Community of Blind and Deaf People
8. Karakol field enterprise of the Kyrgyz Community of Blind and Deaf People
9. Osh field enterprise of the Kyrgyz Community of Blind and Deaf People
10. South field enterprise of the Kyrgyz Community of Blind and Deaf People
11. Djalalabad field enterprise of the Kyrgyz Community of Blind and Deaf People
12. Main board of the Kyrgyz Community of Blind and Deaf People
13. Guest house "Orbita".
14. Republican Independent Association of Disabled people of Kyrgyzstan
15. Homeowners association "Jakshylyk".
16. LLC "Medical Center "Medikos of the Kyrgyz Community of Blind and Deaf People