

# THE LEGAL REGULATION OF NON-PROFIT CORPORATIONS AND THEIR WORK CHALLENGES IN PALESTINE

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## ABSTRACT

*The current study tested the legal regulation of the non-profit corporations (NPCs) in Palestine, as NPCs were regulated by the Palestinian Legislature in the Decree-Law Code No. 6 of 2008. This legislation helped NPCs to engage with different kinds of community services especially because their role implements as a third sector which helps in society developing process.*

*In 2010, the Palestinian Council of Ministers issued a new regulation regarding NPCs, and the Corporations Controller was granted the authority to register them, supervise them, and control their activities, then NPCs start struggling in doing their role and now they are facing “existential challenge” to their legal regulation, which affected negatively their activities.*

*Based on the current findings, study recommends facilitating the role of NPCs by suggesting new strategies which including developing the management system of these corporations and offer the governmental support to help them achieving their goals.*

**Keywords:** Non-Profit Corporations, Corporations Controller, Sustainable Development, Supervision.

## INTRODUCTION

In Palestine, commercial corporations were regulated according to the Jordanian Corporations Code No. 12 of 1964, the Corporations Code in force in the West Bank. This code divided commercial corporations into general partnerships, limited liability companies, private shareholding companies, and public shareholding companies. These are the types of corporations that the Corporations Controller registered until the issuance of the Decree-Law Code No. 6 of 2008, which added new types of corporations, namely civil corporations, holding corporations, and NPCs, the subject of this research (Al-Takroui & Al-Sinnawi, 2019).

Regarding NPCs, we find that Palestine began their legal regulation in 2008 when the Jordanian Corporations Code No. 12 of 1964 was amended, knowing that the Palestinian Council of Ministers issued a regulation for these corporations in 2010. In accordance with the relevant legislation, NPCs have the form of private shareholding companies in terms and registration procedures (6 P.D.C. of 2008 Article 4(b); 3 P.M.R. of 2010 Article 2); the difference between them lies in their objectives, as a private shareholding company is a commercial corporation and aims to achieve dividends to distribute them to its shareholders. In accordance with commercial corporations' contracts, shareholders would have agreed to share such corporations' profits and

losses (Taha, 1997; Al-Shawarby, 1992; Qalioubi, 1993; Al-Takrouri & Al-Sinnawi, 2019; Kalss, 2015). Whether the company achieved dividends or suffered a loss, the shareholders share them all among themselves according to their shares (Lombardo, 2013). At the same time, NPCs are not profit-oriented (Easley & O'Hara, 1983), so the goals of the two types of corporation are different.

NPCs are newly established in the Palestinian legal system. Still, they have received widespread attention and discussion among legal scholars and corporate workers. Tadros, in his study on the legal aspects of NPCs, compares different legal systems, including the Palestinian legal system, and states that the Palestinian legislator did a good thing by organizing NPCs by law and regulation; this, Tadros says, is a good step for these corporations to play a social and developmental role in the Palestinian society, which will enhance the social function of capital (Tadros, 2020).

As for the definition of NPCs, a specific and direct definition has not been stipulated in Palestinian legislations, but Article 4(3)(b) of the Decree-Law No. 6 of 2008 indicated the permissibility of registering NPCs that take the form of a private shareholding company in a special registry called the Registry of Non-Profit Corporations. This article specifies NPC provisions, conditions, and objectives, as well as the actions that they are entitled to exercise, methods of controlling them, methods for obtaining aid and donations, sources of funding, methods of spending and liquidation, the devolution of their properties upon liquidation and death, the data that must be provided to the Corporations Controller, and other matters related to them under a special regulation issued for this purpose.

Palestinian Council of Ministers Regulation No. 3 of 2010, regarding NPCs, stated in Article 1 that an NPC is a corporation registered in accordance with the provisions of this regulation that does not aim to achieve profit. Article 3 of the same regulation indicated that in order for an NPC to be established, its objectives must be to provide a service or economic, social, cultural, civil, developmental, or other activity that would improve the level of citizens in society socially, health wise, professionally, financially, technically, or in sports, cultural, or educational subjects, without aiming to achieve profit; furthermore, if the NPC gains dividends, they should not be distributed to its shareholders.

Thus, we note that NPCs have a vital and important economic role in the process of construction, development, and assistance to society in various fields (Al-Zaimi & Al-Wasmi, 2016; Easley, 1983).

We also note that the Palestinian legal texts did not contain a clear definition of the NPC: their content was limited to the idea that these corporations do not aim for profit. These texts defined the work carried out by NPCs to serve the community. When NPCs gain revenues, these revenues are not distributed to the partners (Tadros, 2020), as stated in Article 8 of the Non-Profit Corporations Regulation: *"1. Any net revenues gained by the corporation shall be considered a savings for it and may not be used except to achieve its goals and objectives for which it was established, and in expanding its activities and increasing its capital. 2. The corporation may not distribute any of its net revenues, directly or indirectly, to any of the shareholders."* As well as what was stated in Article 11(1) of the Council of Ministers Regulation No. 3 of 2010 Regarding Non-Profit Corporations, an NPC has the right to establish activities and income-generating projects so that its revenues are used to achieve its goals. This is

in line with those who have defined the NPC as a company that is prohibited from distributing its net dividends to the people who control it, such as members of the board of directors, its shareholders, or managers (Hansmann, 1980).

Accordingly, it is evident that NPCs do not aim to make any profit (Lombardo, 2013). Still, if profit is made, it is not permissible to distribute it to shareholders (Kameel & Izah, 2020; Al-Zaimi & Al-Wasmi, 2016). The prohibition is not on profit-making, but rather on distribution to the shareholders, whether this distribution is made directly or indirectly, such as through undue rewards or high salaries for members (Easley & O'Hara, 1983). The Ministry of Economy in Palestine requires that this condition be explicitly stipulated in the corporation's articles of association.

It must be noted that the term “*non-profit*,” when applied to corporations, does not denote a type of corporation but rather concerns its purpose and goals. As already mentioned, a non-profit corporation in the Palestinian legal system takes the form of a private shareholding company, and Article 2 of the Council of Ministers Regulation No. 3 of 2010 Regarding Non-Profit Corporations confirmed that “*The non-profit corporation takes the form of the private shareholding company and the provisions of the private shareholding company applies to its registration, capital, and fees charged for the process of its registration, as long as there is no provision in this regulation.*”

Some believe that the Palestinian legislator did well when limiting NPCs to the form of private shareholding companies, which leads to the unification of NPCs under a single legal system, meaning that these corporations are all subject to the same standards and provisions; by contrast, if there were multiple forms, they might be subject to a multiplicity of different standards (Kameel & Izah, 2020).

Some countries tend to exempt NPCs from income tax according to their tax codes, as issues related to tax exemptions are stipulated in the codes related to taxes and not in the Corporations Code (Ellman, 1982). The Palestinian legislature has exempted NPCs from income tax under certain conditions. In contrast, NPCs in Palestine were exempted from income tax according to the Decree-Law No. 8 of 2011 Regarding Income Tax and its amendments (8 P.D.C. of 2011 Article 7(19)).

Granting tax exemptions to NPCs and non-profit organizations is an advantage in developing their work and helping them engage with society to achieve their goals and objectives (Rutzen et al., 2008).

## **Establishment of NPCs in Palestine**

NPCs are established in the same way as private shareholding companies, whether in the procedures that take place with the competent authorities or in the legal requirements for their establishment regarding their capital, the number of shareholders, the liability, or the method of having shares. A private shareholding company's capital is divided into shares that are not subjected to the stock market launch, and the liability of the shareholders in it is limited to the amount of their contribution to the company's capital (12 J.C. of 1964 Article 39(2); Major, 1990). It is also necessary that the number of shareholders be limited to between two and fifty shareholders; also, the shares are not subjected to the stock market launch, but the shareholders

cover the entire company's shares (12 J.C. of 1964 Article 39(2)(b)), and the capital of the private shareholding company must not be less than ten thousand dinars or its equivalent in the legal currency in circulation (6 P.D.C. of 2008 Article 6(c)).

The previous provisions regarding private shareholding companies apply to NPCs because they take the form of private shareholding companies in the Palestinian legal system.

When the application for registration of the NPC is submitted to the competent authority and is duly delivered, the Corporations Controller checks the application and its attachments, and then issues their administrative order to register the corporation within thirty days from the date of submitting the application. If this administrative order is not issued within the specified time, the application will be considered rejected (3 P.M.R. of 2010 Article 5(2)). In the event of an implicit or explicit rejection, the founders of the corporation have the right to object to the administrative order before the Supreme Court of Justice within sixty days from rejection date (3 P.M.R. of 2010 Article 5(3)). In the event that the registration of the NPC is approved, the registration administrative order is published in the government gazette.

Here we point out that the validity of the administrative order of the registration or rejection for NPCs was given to the Corporations Controller in the regulation, and although the provisions of private shareholding companies apply to NPCs, this part introduces a special provision: according to the Jordanian Corporations Code of 1964, which regulates the provisions of private shareholding companies, the validity of the registration or rejection order resides with the Minister of Economy and not the Corporations Controller, and the period for considering the registration application is limited to two months, not thirty days. As for the registration of foreign NPCs, it is permissible for any foreign corporation to establish a branch in Palestine for non-profit purposes with the same terms and conditions as Palestinian corporations.

### **Liquidation of NPCs in Palestine**

Liquidation refers to all the operations that are taken to terminate a corporation's business, settle its rights and debts, and count its proprieties in preparation for dividing them among the partners (12 J.C. of 1964 Article 182; Muhammad, 2016; Al-Takroui & Al-Sinnawi, 2019). The corporation's memorandum of association or its articles of association stipulates the method of such liquidation (Muhammad, 2016).

Article 14 of the Council of Ministers Regulation No. 3 of 2010 Regarding Non-Profit Corporations stipulates special provisions for NPC liquidation: the Minister of Economy, based on the recommendation of the Corporations Controller, may issue a warning to any NPC to correct its position before referring it to liquidation within a maximum period of one month from the date of such warning. After the aforementioned period has expired, the NPC will be referred for liquidation in any of the following cases: a. if the corporation violates the provisions of the law and the regulations pertaining to NPCs; b. if the corporation engages in business and activities that are not within its objectives; c. if any of its activities constitute a violation of public order or morals according to a court ruling; d. if it did not carry out its business for a year, or stopped its business for a year, and did not correct its position within a period not exceeding two months from the date it received the Controller's request to correct its position.

After the completion of the liquidation process, the properties and the assets of the corporation will be distributed (Houghton et al., 1999) as follows:

1. The amount of shareholders' contributions paid into the corporation's capital at its incorporation will be returned to them. If the corporation's properties do not meet the payment of the shares, the distribution is done in proportion to the shareholders' contribution to its capital.
2. If the corporation's properties exceed its capital, the remainder shall be distributed to any NPC or civil organization with similar objectives by an administrative order issued by the Minister based on the recommendation of the Controller.

Consequently, we notice that, in the event of liquidation of NPCs, the partners do not receive any money from the surplus of liquidation except the amount of their shares actually paid into the capital of the corporation at the time of incorporation, and this is consistent with the philosophy of this type of corporation that the partners should not obtain any profits, either directly or indirectly (Tadros, 2020).

Some argue that it is better in the event of liquidation of an NPC that properties and assets are not distributed to shareholders and that these properties and assets should be preserved for donations and non-profit activities because this is consistent with the nature and goals of these corporations (Al-Zaimi & Al-Wasmi, 2016; Tadros, 2020).

An NPC will keep its juridical personality during the liquidation period to the extent necessary for liquidation from the date of the corporation's expiration until the fulfillment of the distribution of its properties and assets at the end of the liquidation phase (Houghton et al., 1999), in order to preserve the NPC and its properties and to take into account the public interest (Taha, 1997; Tadros, 2020) and the interest of the corporation's creditors (Couwenberg & De-Jong, 2008; Colvin, 1995). Thus, the juridical personality of the corporation will remain in existence to such an extent as achieves the goal of its existence, but with regard to the relationship between partners, the corporation's juridical personality does not exist (Radwan, 1989; Muhammad, 2016).

### **Supervising the Business of NPCs**

Supervising the corporation's business means government intervention, represented by a competent authority (the Corporations Controller), to supervise the incorporation process and follow up on its work (Taha, 1997). In the Palestinian legal system, we find that this supervision is both prior to registration and subsequent to registration.

This supervision involves partners submitting an incorporation application to the Corporations Controller, who has the authority to examine and review it and has the right to accept the corporation's registration and issue a certificate for it, to refuse the registration, or not to respond at all, which is considered a rejection after a period of thirty days has elapsed.

Thus, the Non-Profit Corporations Regulation gave the Corporations Controller extensive validity in the process of registering NPCs, as the Controller has the right to accept or reject the registration application; there is no provision in the law or the regulation that identifies cases of rejection of the application or certain criteria that recommend rejection. Still, this matter is left to

the discretion and authority of the Controller, who may refuse to register the corporation, either explicitly or implicitly.

Moreover, the special provisions in the Non-Profit Corporations Regulation regarding the registration administrative order differ from what was stated in the Jordanian Corporations Code of 1964 in force in the West Bank, which regulated the provisions of private shareholding companies and gave the authority to accept or reject the registration to the Minister of Economy and not to the Controller. Also, the period for reviewing the registration application was set at a period of two months and not thirty days, as Article 5(40) of the Jordanian Corporations Code of 1964 states that *“the Minister, upon the recommendation of the Controller, issues an administrative order to register the corporation within two months from the date of applying, and if this order is not issued within the specified time, the application is considered rejected.”*

The subsequent supervision of NPCs involves overseeing its business after its registration and commencement of work; the Corporations Controller supervises NPCs in everything related to the implementation of the provisions of the law and the Regulation of Non-Profit Corporations, and for this purpose they may assign the corporation’s auditor or assign another auditor or any employee from the Corporations Controller Department, at the expense of the corporation, to audit its records and all its activities (Ghaffar & Hammad, 2016; Enriques & Hertig, 2011). When there is a violation of the provisions of the law, the Non-Profit Corporations Regulation, or the corporation’s articles of association, the corporation bears the audit expenses, which are determined by the Minister.

The corporation must also submit to the Corporations Controller an annual report on its business, activities that it has carried out, and its sources of funding, attached with its balance sheet as certified by the authorized signatories on behalf of the corporation and its auditor (Rutzen et al., 2008). When the ownership of the shares of any of the shareholders is transferred to another person for any reason, they are not permitted to charge more than the money they paid for those shares (3 P.M.R. of 2010 Article 6).

In addition, the NPC must adopt a scale for the wages of its employees in line with what their peers receive in labor economics. If the corporation does not comply, the Corporations Controller may take the legal requirement regarding it according to the provisions of the law (3 P.M.R. of 2010 Article 9).

Accordingly, we conclude that there is supervision by the Corporations Controller of NPCs after their registration and commencement of their work, and this places NPCs under strict control of the government; in the event that they violate any provision in the law or regulation, they are subject to warnings or liquidation.

Among the provisions of subsequent supervision that apply to NPCs in Palestine is one that states that prior approval from the Council of Ministers must be obtained to accept grants, donations, aid, and financing; also, the purpose of these donations has to be determined (8 P.M.R. of 2015 Article 1).

Moreover, the subsequent supervision of NPCs represents what was stated in The Decree Law No. 37 of 2018 amending the Anti-Corruption Code No.1 of 2005: this subjected shareholders in NPCs and their employees to the provisions of the Anti-Corruption Code (1 P.C. of 2005 Article 9(4)), and NPCs were also subjected to supervision by the Palestinian State Audit

Administrative Control Bureau under the Decree Law No. 18 of 2017 (18 P.D.C. of 2017 Article 9(g)).

There is also supervision of bank transfers carried out by NPCs, according to Instructions No. 2 of 2016 (Instructions for Banks Regarding the Combat of the Money Laundering and Terrorist Financing of 2016): Article 5 clarifies banks' obligations regarding juridical persons, including NPCs, when transferring money.

### **Challenges of Working for NPCs in Palestine**

Despite the legal regulation of NPCs in Palestine, they have faced many practical obstacles since the beginning of their organization. For instance, the Council of Ministers Regulation of 2010 has been amended by the Council of Ministers to impose stricter supervision on NPCs, as an amendment was made to require prior approval from the Council of Ministers in order to accept gifts, donations, aid, and financing, and to require an indication of the purpose of these donations (8 P.M.R. of 2015 Article 1). The official statement of the Palestinian government on 7/7/2015 stated that it approved the amendment of the Non-Profit Corporations Regulation No. 3 of 2010, which subjected NPCs to the supervision of the concerned institutions. This amendment also ensured that the Council of Ministers had to be informed of the sources of funding for each NPC, as well as their fields of spending in any manner that ensures direct foreign aid to serve the people, in accordance with national priorities and in line with the government's policies and development plans (59 P.M.S. of 2015).

Some argue that, in the absence of any official explanatory memorandum from the government that might explain the reasons for the amendment (according to which it has granted itself the authority to supervise the sources of financing for NPCs without precise controls or standards), this would create severe concerns that the government's endeavor is to dominate NPCs, which would impede their work and limit their development and growth, especially since NPCs, as a type of corporation, are newly established in Palestine (Al-Haq Foundation, 2015).

Some believe that this amendment also affects the freedom of voluntary work and places unjustified restrictions on the exercise of this right, which is guaranteed by the Palestinian Constitution (Basic Law of Palestine), and adds new levels of supervision over NPCs without setting or clarifying any controls or standards for exercising this supervision. Also, this amendment violates the legal capacity of NPCs and diminishes their juridical personality (Moussa, 2020).

Following this, the Palestinian Council of Ministers issued an administrative order in 2016 regarding the mechanism for granting approval to NPCs in order to receive grants and donations, whereby the Corporations Controller reviews the application by scanning the fields of expenditures. After that, the application is referred to the Minister of National Economy, who refers it to the Council of Ministers to make an appropriate decision. The General Secretariat of the Council of Ministers provides the Ministry of Economy with a copy of the decision when it is ready, and then the Corporations Controller provides the Monetary Authority with the decision of the Council of Ministers issued in this regard. The Palestinian Monetary Authority informs the banks operating in Palestine of the decision of the Council of Ministers.

Furthermore, NPCs have been subjected to the strictest control by the state's supervisory institutions; although they are subject to the supervision of the Corporations Controller at the Ministry of Economy, they have also been subjected to the supervision of the Anti-Corruption Commission in accordance with the Palestinian Council of Minister's administrative order (7 P.M.R. of 2015 Article 1 provides that "*non-profit corporations in Palestine are subject to Anti-Corruption Code No. 1 of 2005 and its amendments*") and the amendments of the Anti-Corruption Code (1 P.C. of 2005 Article 9(4)).

Accordingly, we believe that the amendment made by the Palestinian Council of Ministers to place restrictions on the work of NPCs and their freedom to exercise their activity and independence is inconsistent with the Jordanian Corporations Code of 1964 and its amendments, which subjected private shareholding companies to the control of the Corporations Controller. Since NPCs have the form of private shareholding companies, the administrative order of the Council of Ministers, in this case, is not consistent with the law: it makes the Council of Ministers a reference for determining the sources of support for these institutions and a reference to certify their expenditures.

Additionally, NPCs have been subjected to the supervision of the State Audit Administrative Control Bureau (18 P.D.C. of 2017 Article 9(g)). In a report issued by this bureau regarding NPCs, it indicated that there are no clear and compelling reasons for establishing a new type of civil society institution that takes the form of NPCs subjected to the provisions of private shareholding companies, especially because of the similarity between the fields of work, objectives, and sources of financing of NPCs and other civil society institutions.

Accordingly, it is clear that the State Audit Administrative Control Bureau does not believe that there is a need for a special legal regulation for NPCs but rather believes that its legal regulation created confusion in the process of controlling and supervising them.

Consequently, the State Audit Administrative Control Bureau has made several recommendations, including the following:

1. The competent authorities should review the legal regulation of NPCs by including new provisions to control their work and preventing different interpretations of the regulation in a way that ensures the existence of special provisions to guarantee the strengthening of governance.
2. The Corporations Controller should issue comprehensive and sufficient instructions to regulate the registration of NPCs, follow up on their work, and coordinate with other authorities (competent ministries, tax departments, etc.) regarding their registration.

The strict control over the business of NPCs by government agencies continued until an administrative order was issued by the Palestinian Council of Ministers on 16/5/2017 that provides for the suspension of the registration of NPCs in Palestine by the Corporations Controller; from that date until the researcher's question to the Corporations Controller about the registration of NPCs, no NPC has been registered in Palestine, while corporations registered before that date remain under the supervision determined in the codes and regulations (Palestinian Corporations Controller; personal communication).

In fact, suspension of the registration of this type of corporation is inconsistent with the law regulating them and is inconsistent with the reality of development work and the goal of organizing NPCs to achieve the goals of their establishment-that is, to contribute to the



development process in its various aspects. Thus, NPCs have become a problem in government work instead of working with the government in order to be important tools in all aspects of development (Moussa, 2020).

The Corporations Comptroller issued a proclamation on 19/8/2019 regarding the special criteria for registered NPCs, which includes the following (Moussa, 2020):

1. Registering new tax files for NPC employees.
2. The number of authorized signatories on behalf of the corporation should not be less than two.
3. It is not permissible for a person to contribute to more than one commercial corporation.
4. It is not permissible for a single NPC to have a multiplicity of work fields: each one must specialize in a specific field. Pure commercial activities are also prevented.
5. A corporation's total salaries and operating expenses must not exceed a specific percentage of its budget, determined by the Ministry annually, provided that it does not exceed 25%.

Accordingly, we note the government's trend towards imposing supervisory restrictions on NPCs from multiple governmental authorities, and we also note that the government is setting restrictions on the process of obtaining financing and setting several requirements that must be met in order to submit an application for approval to obtain financing, starting with submitting the application to the Corporations Controller in the Ministry of Economy and ending with the decision of the Council of Ministers. All this will involve long periods of scrutiny and examination by various authorities, which will hinder the developmental role of these corporations and their social responsibilities, especially because there is no legal provision in the Palestinian codes and regulations that obliges commercial corporations to bear social responsibility. Also, the importance of NPCs is rising because of the weakness of government programs to support and encourage commercial corporations to carry out social responsibility; some large corporations do take such initiatives, but without adequate guidance for their programs by the responsible authorities (Saade & Khalidi, 2019). Therefore, it is important to promote this type of corporation, since it plays an ethical and voluntary role for development that does not aim to achieve profits but rather aims to act in harmony with the government to serve society in all fields, as social responsibility reflects positively on society, especially in developing countries (Wang & Dong, 2007; Ott, 2009).

## CONCLUSION

NPCs are companies that form an important part of the economies of some countries. They work alongside commercial corporations and associations without aiming to achieve profit but rather to provide a public benefit to society. It is also not permissible for any shareholder in an NPC to have a direct or indirect interest with any commercial corporation that has profitable projects. For these reasons, it has been legally regulated in Palestine to contribute to the development process, which is necessary in light of the Palestinian difficult situation in various respects. Accordingly, it is permissible for individuals to establish this type of corporation, similar to some countries that premised, regulated, and passed a special legislation for it, which is considered acceptable and good.

However, these corporations still faced multiple restrictions in their work in reality due to the multiple control fields on their activities, which these corporations consider a restriction on

their right to work, until an administrative order was taken by the Palestinian Council of Ministers to stop their registration. As we followed the reasons for tightening control over them and stopping their registration in Palestine, it became clear that there is confusion between the nature of the work of these corporations with other civil society institutions, and this is what we have noticed through the report of the State Audit Administrative Control Bureau issued in 2018 on the reality of the work of NPCs in Palestine, in addition to the results and recommendations that came out of this report. Therefore, there is an urgent need to have a clearer government vision for this type of corporation in Palestine as well as an urgent need to work with NPCs to enhance their economic and developmental roles in various fields, direct their work to serve the sectors that need development and help from them, examine the societal and developmental impact of NPCs on the ground, examine the effectiveness of the activities they have in achieving their goals, and directing its work towards the important sectors that need development and strengthening in the Palestinian society within the social responsibilities of these corporations. This requires the government to present a real vision for change in the way they deal with this type of corporation and not to confuse its role, goals and objectives with the associations and civil institutions that are governed by the Civil and Charitable Societies Code, not the Corporations Code. We think that it is better to develop a vision for societal and legal discussion to plan the future of these corporations in a way that achieves its goals and objectives and preserves the independence of these corporations, taking into consideration that this vision should guarantee good governance in their work and development activities, as NPCs are a partner with the governmental sector in the development process, not an opponent. Thus, it is important for the Palestinian Council of Ministers to allow the registration of NPCs rather than prohibit it. We also encourage the development and improvement of the Non-Profit Corporations Regulation to ensure proper management of these corporations and prevent them from competing with commercial corporations.

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