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Types of Business Entities in Ukraine: Problems of Legal Regulation

Genesis and legal base

In Ukraine the division of legal entities is the same like in most others countries. The legal entities are divided on legal entities of Private Law and legal entities of Public Law. That is a theoretical division. In turn the legal entities of Private Law are divided on commercial legal entities and non-commercial legal entities.

Before to give the division of commercial legal entities and their legal characteristics it is necessary to say several words about the legal basis of the business entities.

So what is the legal base of business entities in Ukraine? When did the history of Ukrainian business entities begin?

Actually it began in 1991, because the Soviet Union destroyed any private entrepreneurship and everything was in state property without private founders and companies before.

In 1991, Ukraine became an independent state and the first legal acts were needed. The first, Law of Ukraine “On Business Partnerships”,¹ was adopted September 19, 1991. It regulated the status of joint stock company (JSC), limited liability company (LLC), additional liability company (ALC), general (or full) partnership (FP), and Commandite partnership (CP). By the way in Ukraine to the above mentioned companies there are used two terms: Business Partnerships and Business Associations.

¹ On Business Partnerships: Law of Ukraine No. 1576-XII, adopted 19.09.1991, Vidomosti Verhovnoyi Rady Ukrainy 1991, No. 49, p. 682.

The second Law is Law of Ukraine “*On Joint Stock Companies*”,² September 17, 2008. Today the norms of this law are in use. Law of Ukraine “*On Business Partnerships*” doesn’t regulate the activity of JSC now.

And the last of three main laws is Law of Ukraine “*On State Registration of Legal Entities and Individual Entrepreneurs*”³ that regulates the procedure of company’s registration (May 15, 2003).

Besides the above mentioned there are *Civil Code of Ukraine*⁴ and *Commercial Code of Ukraine*,⁵ that partly regulate activity and operations of companies. For example, in Civil Code of Ukraine there are 53 articles regulating business partnerships and besides this 32 norms that regulate the activity of all legal entities.

And now what are the types of commercial (business) legal entities? Their division is given in *Civil Code of Ukraine* and *Commercial Code of Ukraine*. According to these acts there are:

1. Private Enterprise;
2. Business Partnerships (Associations);
3. Productional Cooperative.

Associations of business entities (should not be confused with business partnerships) are not the subject of our article as they are the unions of legal entities.

Limited liability company

First of all about limited liability company as the most usual legal entity. According to Law of Ukraine “*On Business Partnerships*” *Limited liability company* is a company with the authorized capital divided into shares whose amount is specified in the constituent documents. Members of the company are liable for obligations of the partnership to the extent of their contributions (art. 50). They are not liable for obligations that overrun the registered capital.

The contributions of members become the property of company after its registration.

For example, registered capital of LLC – €10 000. The debt before bank is €30 000. Bank’s losses (if LLC has no another property) will be €20 000, because this part of debt exceed the limit of the participant’s liability.

² On Joint Stock Companies: Law of Ukraine No. 514-V, adopted 17.09.2008, Vidomosti Verhovnoyi Rady Ukrainy 2008, No. 50–51, p. 384.

³ On State Registration of Legal Entities and Individual Entrepreneurs: Law of Ukraine No. 755–IV, adopted 15.05.2003, Vidomosti Verhovnoyi Rady Ukrainy 2003, No. 31–32, p. 263.

⁴ Civil Code of Ukraine No. 435-VI, adopted 16.01.2003, Oficiyniy Visnyk Ukrainy 2003, No. 11, p. 461.

⁵ Commercial Code of Ukraine No. 436-IV, adopted 16.01.2003, Oficiyniy Visnyk Ukrainy 2003, No. 11, p. 462.

The minimum number of participants of such business entity is one participant. If limited liability company has only 1 founder, this LLC may be the founder of no more than one another LLC with one participant. The max number of participants is 100 participants.

Minimal authorized fund – absent. There are no demands. For comparing, in 90ties of XXth century it was 100 min wages (salaries) of hired stuff (near €10 000). From 2008 to 2012 it was one minimal salary (near €100). Of course, someone may ask: “Why is the minimal authorized fund established according to minimal wage of hired stuff in Ukraine”. The main reason, because of high level of inflation in Ukraine during 90ties of XX century. To avoid changing of the minimal registered capital every few years, it was fixed in minimal wages. And where is the minimal wage of hired stuff fixed? It is fixed in a law about state budget. Every year it is reviewed and every next year there is another law. For example, today it is fixed in Law of Ukraine “About state budget of Ukraine on 2014th year”.

Nowadays the inflation is similar to other EU countries. It is not very high. But the tradition of legislative establishing of minimal authorized fund according to the minimal salary has remained. But now it concerns only joint stock companies. For the purpose to attract the investments (especially from European union) the legal provisions concerning LLC’s minimal authorized fund were excluded. And here the opinions of scientists and lawyers have divided. Ones say that the lack of requirements to the authorized fund will contribute to the abuse of unfair businessmen. Their main argument: the lack of requirements to the authorized capital means the lack of any participants’ liability. The others (and the author of this article too) find the advantage of such legislative changes. What are they?

First, it made it easier to do business.

Second, lowering of minimal authorized capital is the trend of EU states. If Ukraine wants to join with EU it has to adapt its legislation and to make it more attractive for EU investors.

As for the company’s operations there are no limits for the kinds of LLC’s activity. The company may work in different fields except that fields of business where another type of company is demanded (for example, pawnshops, banks and some others).

The supreme body of a limited liability company is the meeting of its participants. The participants are the company’s members or their authorized representatives assigned by them. The President of the company is elected by the meeting of the company’s participants (art. 58)⁶.

⁶ On Business Partnerships: Law of Ukraine No. 1576-XII, adopted 19.09.1991, Vidomosti Verhovnoyi Rady Ukrainy 1991, No. 49, p. 682.

A limited liability company shall establish its executive body, which may be collegiate (board of directors) or sole (director) one. The board of directors is headed by the director general. Persons, who are not company's participants, may be the members of the company's executive body.

Supervision over activity of the board of directors (director) of a limited liability company is exercised by an auditing commission assigned by the meeting of the company's participants from among them, the number of its members is provided for by the constituent documents but is no less than 3 persons. Members of the board of directors (director) cannot be members of the auditing commission.

Actually LLC is the main and the most popular type of small and middle business in Ukraine today.

Additional liability company

Additional liability company (ALC) is a partnership with an authorized capital divided into shares whose amount is fixed by the constituent documents. Participants of such a partnership are liable for its debts with their contributions to the authorized capital, and in case of its insufficiency they are additionally liable with their assets in common aliquot amount of their contributions (art. 63).

The limit of the participant's liability is provided by the constituent documents.

Additional liability company is very similar with LLC. Law of Ukraine "On Business Partnerships" directly establishes that the regulations concerning LLC (art. 4, 11, 52–64) shall apply to the additional liability company with regard to the details provided for by the article 63.

Therefore the minimum number of participants is one participant. The max number of participants is 100 participants. The contributions of members become the property of company after its registration.

For example, registered capital of ALC – €10 000. Participant_1 has – 20% of votes (his contribution is €2 000), Participant_2 has – 80% of votes (his contribution €8 000). The limit of the participant's liability is €20 000. The debts of the company before the bank are €30 000. What are the consequences?

Participant_1 shall pay €4 000, Participant_2 shall pay €16 000. Bank's losses will be €10 000, because they exceed the limit of the participant's liability.

Another situation: The first conditions are the same. But Participant_2 has sufficient sum of money to cover risks, and Participant_1 has only €3 000 and no more money, car or other real estate.

Participant_1 will pay €3 000, Participant_2 have money to pay insufficient Participant_1's part, but Participant_2 will still pay €16 000. Despite the fact that the limit of liability is €20 000, the founders will pay only €19 000. Bank's losses will be €11 000, because they exceed the limit of the participant's liability.

To the word, additional liability company is not very popular one as type of company in Ukraine.

Joint stock company

A *joint stock company* (JSC) is an economic entity the statutory capital of which is divided into a certain number of shares of an equal nominal value the corporate rights under which are certified by shares.

In Ukraine a joint stock company is not liable for the obligations of its shareholders. Company and its bodies are indemnified of any sanctions restricting their rights in the event of shareholders committing illegitimate actions. Shareholders aren't liable for the obligations of the company and run the risk of losses related to operations of the company within the value of their shares, unless specified otherwise by law.

Company shareholders are natural persons and legal entities, as well as the State represented in by the body authorized to manage the State property, or a community represented by the body authorized manage communal property as owners of company shares.

There are public and private joint stock companies in Ukraine. There shall be no more than 100 shareholders in a private JSC.

A public JSC may perform public and private placement of shares. A private JSC shall perform only private placement of shares. Should the general shareholders meeting of a private company decide to perform public placement of shares, the company charter is amended accordingly, including a change of the company type from private to public company.

The minimal amount of a joint stock company's statutory capital – 1 250 minimal wages (near €130 000). About the Ukrainian minimal wage it was mentioned above. Today in Ukraine only JCS has minimal registered capital. No other type of business associations has minimal registered capital.

Minimal amount of shareholders – 1 shareholder. Liability of shareholder is limited.

Full (general) partnership

A *full (general) partnership (FP)* is a partnership whose participants (called *full partners* or *copartners*) are engaged in joint business and are jointly liable for obligations of their partnership with all of their assets.

For example, registered capital of FC – €10 000. Participant_1 and Participant_2 have equal parts as they are copartners. The debts of the company before the bank are €30 000. What are the consequences?

Participant_1 shall pay €15 000, Participant_2 shall pay €15 000. Bank's losses will be €0, because full partners have full liability.

Another situation: The first conditions are the same. But Participant_2 has sufficient sum of money to cover risks, and Participant_1 has only €7 000 and no more money, car or other real estate.

Participant_1 will pay €7 000, Participant_2 have money to pay insufficient Participant_1's part, and that is why he will pay an insufficient part of debt – €23 000. Bank's losses will still be €0.

FP is a legal entity. The minimum number of participants is one participant. He is called – full partner. Full partner may be a founder only of one GP. There is mandatory demand for him – to be an Individual Entrepreneur.

A general partnership conducts its business under unanimous consent of all the full partners. Business activities of the partnership may be conducted by all the copartners or one or several of them acting on behalf of the partnership. A copartner of a general partnership may transfer his share (its part) to other copartners or third persons only by consent of all the copartners.

All the rights and obligations of the copartner quitting a general partnership or ceding a part of his share shall be transferred to a third person together with the transfer of the share (its part).

The assignee (heir) is liable for copartner's debts to the general partnership arisen within the period of the partnership's business activity, as well as for the partnership's debts to third persons.

Full co-partners of the general partnership are not allowed to make transactions similar to the objectives of the partnership's business as well as to participate in any partnership with business object similar to that of the general partnership on their own behalf and for their benefit. The aim of this legal norm is to protect the full partnership from clandestine business of someone of full partners. But it is necessary to support the point of view of O.S. Sheremet about changing the method of regulation⁷. Nowadays it is

⁷ O.S. Sheremet, *Legal regulation of organization and activities of a full partnership*, dissertation of PhD, Donetsk 2006, p. 164.

regulated in imperative order. Full partners haven't possibility to allow such partners activity according to their constituent documents. O. S. Sheremet propose (and the author support him) that the method of regulating must be perview (dispositive). In such case full partners may decide themselves to allow or not to allow their same activity apart of full partnership.

If a copartner of a general partnership regularly fails to fulfil or unduly fulfils his/her commitments or his/her actions impede the partnership to achieve its goals, such a copartner may be excluded from the partnership in accordance with the procedure set forth in the constituent documents. The perview (dispositive) method of expulsion is an advantage of full partner expulsion in comparison with LLC where expulsion is exclusive competency of general meeting.

Commandite partnership

A *commandite partnership (CP)* is a partnership with one or more participants (called *full partners*) who conduct business on behalf of the partnership and are liable for the obligations of the partnership with all their assets, and one or more participants who are liable for obligations of the partnership within the amount of their contributions (*dormant partners*).

For example, registered capital of LC – €10 000. Participant_1 and Participant_2 have equal parts as they are copartners. Participant_3 is a dormant (his contribution – €5 000). The debts of the company before the bank are €30 000. What are the consequences?

Participant_1 shall pay €12 500 (full partner), Participant_2 shall pay €12 500 full partner) and Participant_3 (dormant) shall still pay €5 000 as he is liable for obligations of the partnership within the amount of their contribution. Bank's losses will be €0, because full partners have full liability.

As aptly noted by Y. V. Yakovlev Commandite partnership is a perfect union of two different wishes: 1) to rule and to multiply personal capital and 2) to multiply personal capital but to protect it from different risks⁸.

The minimum number of full partners is one full partner. Full partner may be a founder only of one CP. There is a mandatory demand for him – to be registered like an Individual Entrepreneur. The max number of full partners is not regulated. But, as usual, it is no more than 3 full partners.

Dormant partners of a commandite partnership have the right: a) to act on behalf of the commandite partnership only, if they have a power of attor-

⁸ Y.V. Yakovlev, *Commandite partnerships as entrepreneurs*, dissertation of PhD, Kharkiv 2001, p. 194.

ney and act in accordance with it; b) to demand the prior repayment of their contributions (compared with other participants with full liability) in case of the partnership liquidation.

Therefore dormant partner is a specific type of participant. The main disadvantage – impossibility to manage the company. The main privilege – to demand the prior repayment of their contributions in case of the liquidation.

The business of a commandite partnership is exclusively conducted by the partners with full liability (general partners). There is no executive body. If there is only one general partner in a commandite partnership, he/she conducts the business himself/herself.

The dormant partners haven't the right to impede the full partners to conduct the business of the commandite partnership. Decisions of general meeting are made only with consent of all full partners. And, of course, that is understandable, because everybody of them is liable by all his estate.

Private enterprise

And the last type of common business entities is Private Enterprise. It is not a type of business associations. And its legal status isn't regulated by Law of Ukraine "On Business Partnerships". Private enterprise is a legal entity operating on the basis of property of private founder (founders). The founders may be both: physical persons and legal entities. Actually private enterprise is very similar to LLC. It was especially popular in Ukraine in 90ties. And today they are still working. But nowadays that is not very popular to register new ones.

Why was it so popular and what is the difference from LLC?

The main reason of its prevalence (popularity) – no authorized fund that was prerequisite (mandatory condition) of LLC's registration. In 90ties of XXth century the mandatory minimum authorized capital of LLC was 100 minimum salaries (wages) – (equivalent to near €10 000). That was a big sum of money for founders. That's why, often small and middle business were registering like Private Enterprises.

But the main disadvantage – one founder (or two founders with equal shares – 50% of registered capital for each member). So if the one founder wants to attract investments to his company he hasn't possibility to include a new participant. Only way out the situation – to reorganize the PE. But restructuring is a difficult complex and long procedure. Its term – minimum 3 months. Besides this mandatory tax inspection, pension inspection. In contrast registration of legal entity takes only 3 days.

Today according to Ukrainian legislation there is no mandatory registered capital for LLC. That is why LLC is more and more popular and PE is losing its significance as type of small business.

Common conclusions

Above there were given the characteristic of main business entities. The main conclusions are next:

The trend of Ukrainian legislation as well as other EU countries' legislation must be wider applying of the perview (dispositive) method in regulating of business relationship in national legislation.

Full partnership and commandite partnership have some advantages before such main types of business as JSC and LLC. The main of them – full support of creditors' claims. That's why, it is necessary to establish mandatory registration of some business (like pawnshops, credit unions) as FP or CP at legislative level.

Ukrainian private enterprise is a relic of transition economy. Therefore the Ukrainian legislative body must focus his attention on more detailed regulating of LLC, JSC than such transition model as private enterprise.

Abstrakt

Artykuł analizuje ukraińskie prawo spółek. W artykule przedstawiono specyfikę podmiotów gospodarczych na Ukrainie takich jak spółki (spółka z ograniczoną odpowiedzialnością, spółka z dodatkową odpowiedzialnością, spółka akcyjna, spółka jawna, spółka komandytowa) i inne podmioty gospodarcze (prywatne przedsiębiorstwa). Zanalizowano specyfikę statusu prawnego podmiotu i udziałowca (akcjonariusz, wspólnik), zarządzanie, cedowanie. Autor przedstawia ich powstanie, zalety i wady oraz proponuje kierunek zmian w ukraińskim prawie spółek.

Słowa kluczowe: podmiot gospodarczy, typy spółek na Ukrainie, spółka z ograniczoną odpowiedzialnością, spółka z dodatkową odpowiedzialnością, spółka akcyjna, spółka jawna, spółka komandytowa, prywatne przedsiębiorstwa