ZESZYT NAUKOWY
Wyższa Szkoła Zarządzania i Bankowości w Krakowie

Jakub Cichuta
Uniwersytet Warszawski
jakub.cichuta@gmail.com

LIMITED LIABILITY COMPANY. SOME COMPARATIVE REMARKS

INTRODUCTION

Limited liability company is not the oldest or a model form of incorporation. However, this solution is widely recognised and absorbed in many jurisdictions. Born in 1892 in Germany, spread throughout the world. Nowadays, it appears outside of civil law jurisdictions, in Asia or in common-law-tradition countries.

The institution that is my research focused on is playing a great role in economic turnover. It is a choice interesting especially for smaller businesses, but not only to them. It makes a company more personally-oriented than a company with transferable shares. Therefore, it gives more stability for the less experienced or more directly concerned participants of the market. Analysis of its popularity and advantages will be present in later chapters.

I focus on three jurisdictions in my research: Poland, China and United States. In Poland, german concept of a *Gesellschaft mit beschränkter Haftung* was absorbed mainly intact. That is why I chose polish jurisdiction to present classical construction of this type of incorporation. What is worth noting, the number of limited liability companies (sp. z o.o.) operating in Poland is greater than that of companies *sensu stricto*, that means companies with transferable shares (S.A.)[1].

My choice of Chinese jurisdiction was inspired by the fact that Chinese legal system is influenced both by civil law tradition (especially germanic tradition and *Bürgerliches Gesetzbuch*) and American common law, because of intensive economic relations. That is a reason why Chinese version of limited liability company is interesting to be analysed - which aspects are likely to be omitted outside of civil law Europe, what are common law features which could and fit in this specific model created more than one hundred years ago in the authoritarian German Empire.

[1] A. Koch, J. Napierała *Prawo spółek handlowych* Warszawa 2013.

United States are an example of a newcomer in the group of jurisdictions which incorporated a concept of a limited liability company. In a way it is one of the most interesting jurisdiction concerning comparative legal perspective. It is caused by the fact that it is a kind of a transplant from very different system, stressing safety, stability and credibility not an American freedom, profit-pursuit and flexibility. Even a question whether one may put the American LLC concept in the same category as the civil law ideas presented in other two jurisdictions, must be answered.

1. Poland

Limited liability company in Poland is based on two principles. First one is to grant benefits of legal personality and dividing company's assets from shareholder personal assets. According to the mentioned principle main characteristic of LLC in Poland (*spółka z ograniczoną odpowiedzialnością* in Polish nomenclature) is a legal personality. It is no different from joint stock company in this respect. Second principle is to establish an entity which would be less formal, easier to operate and more appropriate for small businesses than joint stock company (*spółka akcyjna* in Polish nomenclature).

The definition of a LLC company may go as follows - „LLC is a capital commercial company, created in any lawful purpose, which share some characteristics with personal companies and in which participate individually marked shareholders. Those shareholders may transfer they shares, however, shares could not be embodied into transferable documents"[2].

First characteristic points out, that *sp. z o.o.* is a part of capital companies family, together with company limited by shares. This suggest closer relations with joint stock company than with personal companies as partnerships. Only those two capital companies are equipped with legal personality and shareholders are not responsible for company's debts, shares are non-executable by a personal creditor.

Second feature is that it may be created in any lawful purpose, not only commercial one. This is different than, for example, in China but it is of small significance due to different possible legal options for non-profit actions[3].

Main difference, and influence of personal character, between *sp. z o.o.* and *S.A.* is individualisation of shareholders and lack of embodiment of shareholder rights in a document.

[2] A. Koch, J. Napierała *Prawo spółek handlowych* Warszawa 2013, p. 264.
[3] *ibidem,* p. 270;

It creates the situation in which shareholders of a company are publicly known and transfer of shares needs individually crafted contract, excluding the possibility of public trade on regulated market.

Other sign of personal aspect is personal control, shareholder in an LLC has much more power towards the company and more option of supervision over management than in a joint stock company. They may inspect books, records, state of finance and wealth. Supervisory body is obligatory only when number of shareholders exceeds 25 and share capital exceeds 500 000 PLN. Shareholder may be excluded by the court and company dissolved.

Creation

In order to create an LLC, the fundamental step is a contract between future shareholders. Natural, legal and defective legal person may be a shareholder. The contract must be done in a notarial form under a sanction of invalidity of the contract. This moment is a start of LLC in organisation. Creation of a one person LLC also demands a notarial form.

The contract must include firm (name), domicile, scope of business, share capital, type and value of shareholders' contributions and nominal value of shares. However, the contract may regulate many more areas important for the company. As a rule, to amend the articles, a majority of 2/3 of voters is needed. However, measures specifically diminishing the role of a shareholder or increasing their burdens need that specific shareholder's approval[4].

The capital must be covered in full in order to establish a definitive LLC. Minimal amount of the share capital is 5000 PLN. Capital may be covered in cash, wealth or transferable rights, nevertheless there is a discussion in Polish legal academia and judiciary whether the right of use, which could give a real benefit for the company but is untransferable, may be contributed. After coverage of the share capital, the company in organisation may file submission to the National Court Register and with the moment of registration, it becomes an official and definitive LLC. Until that moment, shareholders are jointly liable for the obligations of the company in organisation[5].

The share capital is divided into shares. Minimal value of a single share is 50 PLN. The contract of the company may give some privileges to some shares. It may touch a matter of dividends, voting and liquidation procedure. However, there are statutory limits on the extent of the privileges[6]. Limits on the transfer of shares may be constructed in various ways, but the

[4] *ibidem,* p. 277-280;
[5] *ibidem,* p. 278-284;
[6] *ibidem,* p. 306.

statute does not allow exclusion of the right to transfer one's share. Nevertheless, To complete the transfer, notification of the company is mandatory to make it effective.

The shareholders' meeting[7]

Shareholders' meeting is a body that gather owners of the company. It amends the contract of the company, accepts records of the management and supervisory board. Its approval may be needed to purchase or sell real property and electing the management. Meetings are called by the management board, at least once a year. The meeting accepts the work of the management and decides on dividends or coverage of losses. Extraordinary meetings are to be called if a tenth of shareholders (in terms of proportion of share capital) demand it, losses exceeds certain statutory level, when it is necessary for the activities of the company or when the management deems it as purposeful. However, the supervisory body is obliged with calling the meeting, if the management does not fulfil its duties in this respect.

Any issue that is to be addressed during the meeting has to be mentioned in the agenda sent to shareholders before the meeting. Proxies are allowed. Moreover, shareholders are allowed to solve different matters by exchange of written statements, outside of the meeting.

The management board[8]

The management is an obligatory body. It is responsible for day-to-day business activity of the company. The contract may regulate competences to elect the body, criteria necessary for members, number of members of the board etc. By default the shareholders' meeting has power to nominate the board. If the term is not stated, it lasts one year. It always expires on the date of the meeting that accepts the records of the management.

The management board represents the company. The way of representation is publicly known by the National Court Register database. Default provision states, that two members of the board are efficient representation or one member with the proxy. There are provisions tackling conflict of interest. The members of the board are personally responsible for the obligations of the company with some exculpation possibilities[9].

Supervisory bodies[10]

Supervisory bodies are facultative in the LLC, because of the more direct supervision of the owners. There are two types of bodies that may be established. First is revisory committee. By default it is only used to assess annual records of management and financial

[7] *ibidem,* p. 336-343.
[8] *ibidem,* p. 326-336.
[9] *ibidem* p. 335.
[10] *ibidem,* p. 343-346.

state of the company. It may have its competences broadened in the absence of the supervisory board. More important body is mentioned supervisory board. It may absorb competences of the revisory committee. It may have its competences broadened as to obligatory acceptance of some type of actions planned by the management.

Both bodies must have at least three members and they cannot be recruited from people whose activity may be scrutinised by the supervisory body.

2. China

Present version of a limited liability company in China was introduced in 2005 Company Law change. The LLC existed in China in previous version of the law, however, changes were so profound that the 2005 statute is considered rather a new one than a change[11].

An issue must be explain here, that the Hong Kong corporate nomenclature is different than in the mainland China[12]. More exposed to the Anglo-Saxon influence, it more resemble US system than a civil-law-derived vocabulary of the Mainland China.

Ownership and establishment

The mentioned statute in its official English translation uses a word „shareholder" as the name of a person who wants to establish a limited liability company. However, legal academics states that the main difference between the LLC and company limited by shares (second type of business organisation mentioned in the statute) is that in the former ownership is constructed in the way of membership rather than ownership of shares[13]. The LLC is much more connected with people who are creating it than joint stock company. The membership is reflected in lack of guarantee to enter or exit a company. The LLC as a company is equipped in the legal personality and is a subject to a corporate income tax.

In order to establish a limited liability company a group of future shareholders must formulate Articles of Association, full capital contributions required by the articles must be submitted (instalments are not allowed), name and domicile must be set and organisational structures must be formed. Form of contribution are prescribed: money, things, rights - nor labor nor credit. Scope of activity is mandatory and strictly observed in China. In order to change it, the articles must be changed so it is advised to choose it rather broadly[14]. The

[11] Gu M. *Understanding Chinese company law* Hong Kong 2010.
[12] *ibidem,* p. 26-27.
[13] *ibidem,* p. 33.
[14] *ibidem,* p. 65-67.

maximum number of shareholders is 50. It is difference from Polish and American systems, where there is no such limit.

The transfer of a share by a shareholder to any non-shareholder is subject to the consent of more than half of the other shareholders. The shareholder must notify the other shareholders in writing. Failure to reply by any of the other shareholders within 30 days is deemed as consent to the transfer. Where more than half of the other shareholders do not consent to the transfer, such non-consenting shareholders are obliged to purchase. Otherwise, the purchase by a third-party is allowed. Where two or more shareholders claim their preemptive right, they shall determine the proportional ratio for purchase through consultation. Where the consultation fails, the preemptive right shall be exercised in proportion to their respective capital contribution at the time of the transfer. However, this aspect may be prescribe differently in the Articles of Association.

The dividends is distributed in proportion to the actual capital contributions paid up by them, unless otherwise agreed upon by all the shareholders. In the event of capital increase of the company, the shareholders shall have the priority to subscribe for capital contribution proportionate to their actual paid-up capital contributions, unless otherwise agreed upon by all the shareholders.

The company may issue bonds when its net capital exceeds 60 million and bonds may value less than 40% of company's assets. Dividend is distributed after losses from previous years are covered, then taxation has place and 10% of what is left is directed into the reserve (except when company have reserve valued more than 50% of capital), then the dividend may be distributed proportionally to the capital contribution. The shareholders meeting may give additional amount to the reserve[15].

The shareholders meeting

As typical for the shareholders position in an LLC, the rights of shareholder in supervising the company are more important than in a corporation.

Shareholders may inspect and duplicate the company's articles of association, the minutes of the shareholders' meetings, the resolutions of the board of directors, the resolutions of the board of supervisors, and the financial and accounting reports of the company, request to inspect the accounting books of the company. If the company has reasons to believe that the shareholder's request is for any improper purpose the company may reject the request. Should

[15] *ibidem,* p. 96.

the company refuses to allow inspection by the shareholder, the shareholder may request the competent court to provide the access.

The shareholders meeting is required once a year, voting by proxy is permitted. Strength of the vote is dependant on proportion of contributed capital, Chinese law does not divide capital into equal shares as in Poland. On the meeting are imposed obligations more typically connected with management of the company[16]. There are opinions that it is a result of the less developed Chinese business and the need to safeguard influence of owners on the development of the company. Second aspect is the fact, that State is often a shareholder of LLC and corporations[17]. Rights and obligations of the shareholder meetings include making decisions on the company's operation guidelines and investment plans; electing and replacing the directors and supervisors and making decisions on the matters concerning the remunerations; approving the reports of the board of directors and the board of supervisors; approving the annual financial budget plans, final accounts of the company and profit distribution plans or loss recovery; making resolutions on the change of the company's registered capital or a merger, division, dissolution or liquidation of the company or on the conversion of the corporate form; modifying the company's articles of association.

Where all the shareholders have reached a written consensus a decision may be directly made without convening a shareholders' meeting. Regular meetings are held according to the company's articles of association. An interim meeting shall be held if so proposed by the shareholders representing more than one tenth of the voting rights, more than one third of the directors, the board of supervisors, or in the absence thereof, the supervisors.

Board of directors

The board of directors comprises of 3 to 13 members. A limited liability company with relatively few shareholders or of a relatively small size may have one executive director instead of a board of directors. The executive director may concurrently hold the post of the manager of the company. Term cannot exceed three years. The director continues acting as a director until replacement. But it causes problems, e.g. when director dies[18]. The law provides situations when a director is disqualified *ex lege*.

Chairman of the board is the only legal representative of the company. Only his or her sign makes a contract validated. Manager may be given such a power by the board. Otherwise

[16] *ibidem*, p. 75.
[17] *ibidem*, p. 78.
[18] *ibidem*, p. 85.

a seal of the company is needed[19]. A director may be assigned a manager. However, manager is only an assisting organ, responsible to the board of directors. Is elected and dismissed by the board. Articles of Associations may modify the powers of the manager. The manager should attend meetings of the board of directors as a non-voting participant.

The board may include representatives of the workers, elected by employees.

Supervision

A limited liability company should have a board of supervisors which is composed of at least three members. Nevertheless, a limited liability company with relatively few shareholders or of a relatively small size may have just one or two supervisors.

The board of supervisors shall include representatives of the shareholders and an appropriate proportion of representatives of the staff members of the company. The specific proportion of the latter shall be specified in the company's articles of association, subject to a minimum of one-third. The representatives of the staff members in the board of supervisors shall be elected democratically by the staff members of the company through a general meeting of the representatives of the staff members, a general meeting of staff members, or in other forms. The term of office of a supervisor shall be three years. The board of supervisors shall convene a meeting at least once a year, and the supervisors may propose to convene an interim meeting of the board of supervisors.

The board of supervisors or, in the absence thereof in a company, the supervisors shall exercise *inter alia* conducting inspection of the financial issues of the company; supervising the performance of duties by the directors and senior management personnel, and submitting a proposal on the removal of any director or senior management person, or senior management personnel; proposing to convene interim shareholders' meetings, and convening and presiding over shareholders' meetings when the board of directors fails to perform the duties; putting forward proposals to the shareholders' meeting; filing actions against the directors or senior management personnel.

Special types of the LLC[20]

One person company does exist in Chinese law with special set of provisions. What is the most important, the law provides liability of the only shareholder if mixing of company's and shareholder's possessions has place. Liability also appears in generally stated abuse of

[19] *ibidem,* p. 86.
[20] *ibidem,* p. 96-106.

corporate form and legal personality. It may be said, that Chinese law allows piercing of the corporate veil in this aspect.

There are special provisions about „Wholly state owned LLC". They need the central or local government approval. M&A are tightly supervised by the special governmental agency and common provisions are excluded in favour of provisions made by this agency. The last category are „Wholly foreign owned LLC". They need the Ministry of Commerce approval, at least 25% of contributed capital must be in cash.

3. USA

A Limited Liability Company first appeared in Wyoming State in 1977. Some authors call it the „Wyoming experiment"[21]. Since then an LLC is gaining its popularity. There are a few basic differences between a corporation and LLC. First of all owners of the LLC are not even called shareholders but members. What is more, members can manage the LLC directly and still be free from personal liability unlike general partners in partnerships or a "limited" partner in a limited partnership taking the liability of a "general" partner if manages the partnership[22]. It could be also a source of frictions between investing and managing members, because investing partner has the same scope of competences as the partner conducting business and may block managing partner's activity. There is no maximum limit on number of members, but there must be at least two members, one-person-owned company cannot exist in American legal system. "Members" can be natural persons, corporations, partnerships, or other LLCs. There are no officers such as a president, secretary, etc.

The Articles of Organisation must be submitted to a Secretary of State. The articles must include name of the LLC, its domicile, members and managers and the date or event when the LLC will dissolve (up to 30 years in some states) - LLCs are not granted an unlimited life. Purpose have to be specified and the Operating Agreement is recommended[23].

In general, the purpose of forming a limited liability company is to create an entity that offers investors the protections of limited liability and the non-double-taxation status of partnerships

[21] Bruce Hawley *Limited liability companies* Reporter no. 20, p. 4-7 (1993);
[22] *ibidem,* p. 5.
[23] *ibidem,* p. 6-7.

to qualify for pass-through tax treatment. To achieve that goal business entity must possess more "noncorporate characteristics" than "corporate characteristics"[24]. The critical issue in determining whether a limited liability company will be taxed like a corporation or a partnership is how closely it resembles a corporation.

The U.S. Treasury Regulations provide that a firm is a corporation rather than a partnership if it has three of the four characteristics: (1) continuity of life; (2) free transferability of interests; (3) centralization of management; and (4) limited liability[25]. The Internal Revenue Service has clearly stated that it will grant partnership (i.e., without double taxation) tax status to limited liability companies as long as they do not possess the corporate characteristics of continuity of life and free transferability of interests.

There could be pointed some common features with S-corporations. However, unlike S-corporations, limited liability companies cannot be formed in perpetuity without losing their tax status. Moreover, LLCs are free from restrictions on the type and number of shareholders they may have. In particular, Subchapter S limits the number of shareholders to thirty-five, forbids the creation of more than one class of stock, and prohibits the company from owning a subsidiary[26]. And, like other corporations, S corporations have restrictions on the amount of dividends they can pay, must maintain certain capital accounts, and must be managed by a board of directors or an equivalent body. None of these restrictions on organisation and management are imposed on limited liability companies[27].

Concerns were put up in the US discussions, that rising of LLCs may lead to the death of partnerships, because an LLC grants the most important features of a partnership without some disruptive restrictions[28]. The effect of such predictions coming true, would be a business environment in which all forms, except sole proprietorships, would enjoy the benefits of limited liability, and all entities except publicly traded corporations could enjoy the benefits of single taxation. The exception to this general rule is that each member of a limited liability company will be liable for the consequences of her own wrongful or negligent acts, as well as for

[24] J. R. Macey, *The Limited Liability Company: Lessons for Corporate Law*, Wash. U. L. Q. no. 73 p. 433 - 454 (1995);
[25] *ibidem*, p. 434.
[26] *ibidem*, p. 435.
[27] *ibidem*, p. 436.
[28] *ibidem*, p. 436-437.

wrongful or negligent acts of people under her direct supervision[29]. The doctrine of piercing the corporate veil is applicable to LLCs[30].

Conclusions

Common trait of constructions analysed in this article was the hybrid nature of the Limited Liability Company. In each jurisdictions merger of a partnership (personal character) and a corporation (capital character) is claimed. However, there is a visible difference. Limited Liability Company in People's Republic of China and Poland is kind of a younger, easier brother of a fully capital corporation (s*półka akcyjna* or joint stock company) but still member of the same family. They are different type of entity than partnership. They are equipped with legal personality, double taxed, management is visibly distinct from ownership, however, definitely less distinct than in corporation. In the United States Limited Liability Company belongs more to the partnership (personal companies) than to corporations. It is deprived of legal personality, nevertheless it is rather a positive, because that gives it preferential tax treatment. The most striking difference between the LLC and the partnership is limited liability (that is different than partnership and it is an aspect present in every jurisdiction).

It is interesting to compare two similar civil-law-derived concepts - Polish and Chinese LLCs. There are two main differences. First one is that of general construction. Polish regulation is much more detailed and cogentive. It has more mandatory provisions and structure of the company is more statutory set. In China there is more flexibility in fundamental issue. The main sign of it is facultative management (board of directors) in small sized LLCs, which is mandatory in Poland. This moves us to the second aspect - in China we may see greater role of owners, the shareholders. The shareholders meeting competences are more influencing management of the company, the board of directors is not mandatory, it seems that in country with less developed legal and business culture that is a preferred answer to the agent-principle dilemma - to give more power to the owners, at the cost of managers that have more opportunities to abuse their powers.

The last aspect that is common for every jurisdiction is the fact of popularity. The LLC is more common in Poland than corporation limited by shares, more LLCs are created than corporations in the US and it is also a desired business form in People's Republic of China.

[29] *ibidem,* p. 438-440.
[30] *ibidem,* p. 441.

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Streszczenie

Spółka z ograniczoną odpowiedzialnością jest jedną z najbardziej popularnych prawnych form prowadzenia działalności gospodarczej. Dzieje się tak w wielu systemach prawnych, nawet krańcowo od siebie dostępnych. Próba znalezienia punktów wspólnych oraz różnic metodą komparatystyki prawniczej może być pomocna w wytłumaczeniu fenomenu popularności spółki z ograniczoną odpowiedzialnością. Zakres uproszczeń i ułatwień dla sp. z o.o. w porównaniu do modelowej spółki kapitałowej w danej jurysdykcji jest bardzo różny. Jednak upraszczanie struktury i przede wszystkim bardziej bezpośrednia kontrola właścicieli nad działaniami spółki są czynnikami występującymi we wszystkich badanych jurysdykcjach.