

Does the business entity model still matter in Lithuania?

Ieva Strunkienė gives her thoughts on whether or not the legal form of an individual enterprise is still relevant for a modern business in Lithuania



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In Lithuania, there is a dual regime for the conduct of individual business activity,¹ i.e., two models of individual business activity conducted either in an incorporated or an unincorporated manner.

The unincorporated form of individual business activity can be commenced in three ways:

- by declaring the status of self-employment under an individual activity certificate from the date of their activity with the tax administration;
- from the date of acquisition of a business license; or
- from the date of registration of a farm.

The incorporated form of individual business activity, acting as a legal entity, starts from the moment the legal entity is registered in the Register of Legal Entities (RLE).

Currently, Lithuania is searching for a legal regime for simplified individual business insolvency proceedings. This raises issues over how legal rules govern the interaction between insolvency proceedings in respect of an individual enterprise (IE) operating in an incorporated form and those of its owner.

The individual enterprise is a specific form of individual business organization in Lithuania,² so it is very important to critically assess its relevance in the context of the modern business. First, the registration of an IE with the RLE is necessary, which requires the preparation of the founding documents.

Registering an IE involves the increased cost of incorporation and time to launch business

activities. Second, as a legal person, an IE must have a single-person management body – the head of the enterprise; information on his/her employment must be submitted to the National Insurance Fund Board, and the head of the enterprise must be paid a salary and the corresponding taxes. Third, not only is the owner of the IE a taxpayer, but also the IE itself, as it is subject to corporate taxes. Fourth, the accounting records of an IE must be kept in accordance with procedures laid down in accounting legislation. Fifth, the specific features of the IE may influence cases of lesser trust of company's contractors.

Sixth, the small scale of the IE's activities makes it difficult to recruit highly-qualified staff, which results in a lack of professional management. Seventh, the procedure for liquidating an IE (because of insolvency proceedings) is more complex, as the liquidation procedure is subject to provisions of the insolvency articles regulating legal persons and also partly subject to Law on Bankruptcy of Natural Person (LBNP). Eighth, an IE is a legal person with unlimited civil liability, which determines the peculiarities of its civil liability, i.e., despite the fact that an IE and its participant are separate entities capable of independently assuming obligations and consequent liability, and the principle of the separation of the assets of the IE and the IE participant is in place, in the event the IE does not have enough assets to settle its property obligations, the IE's participant

has a secondary liability for the IE's debts.³ Ninth, the insolvency of an IE is considered to be highly disadvantageous for the participant, while the insolvency process is highly advantageous for the creditors, as the relevant legislation provides for the discharge of the IE's obligations to its creditors not only out of the assets of the IE itself, but also out of the assets of the participant.

According to the model chosen by Lithuania, the IE insolvency process is prioritized in terms of time, i.e., is not possible to commence the bankruptcy proceeding of a natural person (Article 5(8)(6) of the LBNP) if the IE managed by him or her is subject to bankruptcy proceedings. The national regulator has stipulated that the insolvency proceedings of the IE must be completed, first, which also includes the claims of the creditors to the natural person as the participant in the IE. Where the proceedings against an IE are wound up, the IE ceases to be a participant in civil law relations and the claims of its creditors are extinguished, but the obligations of the owner (participant) of the IE as a natural person towards his personal creditors are not terminated.

Before the adoption of LBNP, it was not possible to write off debts of this kind and creditors had the right to enforce their debts indefinitely. The adoption of the LBNP changed this and enabled a natural person who is an entrepreneur to apply for the opening of bankruptcy proceedings against him/her in case there are still outstanding claims of the creditors to the IE



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business owner after the closure of the proceedings against the IE business itself. The chosen method for solving the insolvency problems of a natural person who is a sole trader is complicated, not only because two bankruptcy proceedings have to be conducted in sequence, but also because the creditors of the natural person are included in the bankruptcy proceedings of the individual enterprise (a common list is drawn up), but the relations between the creditors, the different statuses of the creditors, and the ranking of their claims is not governed by the legislation.

The liquidation of an IE due to its insolvency and the deregistration of an IE from the Companies Register terminates only the obligations of the IE to its creditors, but this does not affect the termination of the personal obligations of the participant of IE as a natural person. Creditors of a participant, who have participated in the

insolvency proceedings of an IE, have the right to continue the recovery of debts from the assets of the participant if they were not paid, under the general procedure, specified in the Civil Procedural Code of the Republic of Lithuania.

Granting legal personality rights to the individual enterprise model, where a natural person who is an entrepreneur chooses the legal form of a sole proprietorship to carry out economic activity, does not meet the needs of modern individual business practice, therefore it is necessary to grant (to return) by law the rights of a natural person to individual enterprises (as was the case prior to 1 July 2001), and to apply the provisions of the LBNP to the resolution of the issues related to the insolvency of an IE in such cases. Meanwhile, if the national legislator does not support the idea of granting IE the status of a natural person, it is necessary to adjust the insolvency

legislation to provide that natural persons exercising the right to engage in economic activity in the legal form of an IE would be recognized as entrepreneurs (including in their self-employed professional capacity), and that the insolvency proceedings of the latter would be governed by the insolvency law of legal persons (in the appropriate scope). ■

Footnotes:

- 1 The unique features of individual business in Lithuania demonstrate that it meets all of the criteria for the universally understood definition of an SME, and it is therefore appropriate to add a new concept of individual business to the legislation governing SMEs, describing an individual business run by a single natural person as the conduct of economic activity of an SME. In the interests of legal clarity, and economic effectiveness in a manner likely to stimulate entrepreneurship by sole traders, there is a need to create procedures for more efficient bankruptcy proceedings of SMEs. It is therefore also proposed to adopt amendments to the SME legislation to achieve this.
- 2 An individual enterprise is considered to be a private legal person with unlimited civil liability, which means that when such an enterprise does not have sufficient assets (or has no assets at all) to pay for the obligations assumed by the IE, the participant of the IE has a subsidiary obligation to be liable for the debts incurred by the IE.
- 3 Resolution of the Supreme Court of Lithuania of 7 December 2012 in civil case No 3K-7-400/2012.



The adoption of the Law on Bankruptcy of Natural Person enabled a natural person who is an entrepreneur to apply for the opening of bankruptcy proceedings against him/her



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