

## II.2. DERECHO MERCANTIL

### PECULIARITIES OF INDIVIDUAL ENTERPRISES ACTIVITY REGLAMENTATION IN LITHUANIA

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#### **Resumen**

El artículo analiza el problema teórico y práctico de las peculiaridades de la reglamentación lituana de la actividad económica de las empresas en vigor desde el 1 de enero de 2004 que trata de ordenar tal actividad hasta ahora regulada por diversas normas que causaban muchos inconvenientes. El artículo analiza la empresa individual como entidad legal con sus ventajas e inconvenientes y tanto antes como después de la entrada en vigaor en 2004 de la nueva reglamentación.

#### **Abstract**

The paper analyses the problem, which is relevant, both theoretically and practically, since it tries to disclose legal and economical peculiarities of individual enterprises activity reglamentation. Until now, operation of individual enterprises established in Lithuania was regulated by various separate laws which caused much inconvenience. As a result, the Law of the Republic of Lithuania on Individual Enterprises entered into force on 1 January 2004. This article aims to present outstanding peculiarities of the individual enterprise as a legal entity which could be considered as certain advantages and disadvantages. The article considers the individual enterprise before and after the entry into force of the Law of the Republic of Lithuania on Individual Enterprises.

## SUMARIO

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## I. INTRODUCTION

Individual enterprises in every country form the majority of the subjects of commercial law (Bennour *et al.*, 2007; Heffernan, 2006; Čiburienė, 2005 and others). Lithuanian is no exception. According to the data of the Lithuanian Department of Statistics, in 2003 individual enterprises amounted to 51 percent of registered economic entities; in 2004 they amounted to 48 percent, in 2010 –28.6 percent. Part of individual enterprises conduct agriculture related activities and 247 of them are the owners of land holdings. From the national point of view, individual enterprises on private initiative increase budget receipts of the municipalities and the state, decrease shadow economy, create new work places, create prerequisites for formation of the middle layer of population, and decrease demand of social support.

The article considers legal aspects and peculiarities of individual enterprises in modern legal theory and practice. The Law of the Republic of Lithuania on Individual Enterprises specifies the norms which make direct impact on operating individual enterprises and their owners. Also, emphasis is made on the importance of this Law for further operation, establishment and liquidation of individual enterprises.

## II. RESULTS

The majority of the subjects of commercial law (i.e. economic entities which have the right to professionally conduct commercial economical activity in the name of their company) in the Republic of Lithuania is made of companies. The general legal principles of establishment and operation of companies are set forth in the Law of the Republic of Lithuania on Companies. The requirements on legal foundation of establishment, operation, reorganization, and liquidation of particular types of companies as well as other specific requirements are established in the laws and other legal acts for particular types of companies (Šatas, 1998).

The following types of companies can operate in the Republic of Lithuania:

1. individual (personal) enterprises;
2. real partnerships;
3. commandite (trust) partnerships;
4. public limited-liability companies and private limited-liability companies;
5. State-owned (municipality-owned) companies (Kirsiene *et al.*, 2004).

The Lithuanian laws empower people to possess companies. Such companies are called individual enterprises. The individual enterprise is a private legal entity of unlimited liability. It should be emphasized that after the new Civil Code entered into force on 1 July 2001, individual enterprises became legal entities. The general norms of the Civil Code are applied to them similarly as to other legal entities. The Law on Companies is applied to a certain extent unless it contradicts the Civil Code (Railaitė, 2003).

Establishment, management, transformation, liquidation of individual enterprises, the rights and duties of the owners of these enterprises are regulated by the Law of the Republic of Lithuania on Individual Enterprises which entered into force on 1 January 2004. Prior to the entry of the Law into force, operation of individual enterprises was not defined by any particular law. The arguments on the necessity and purpose of preparation of the new law are as follows:

1. The individual enterprise was the only type of companies which was not regulated by any particular law.
2. Legal provisions regulating individual enterprises were scattered in different laws which caused inconvenience. The need to solve «arising problems which constrained the existence of individual enterprises» emerged (Vileita, 1997).

According to the Law, the individual enterprise may also be owned by right of ownership by non-production organizations which have the rights of the legal entity. The owner of the individual enterprise may be a natural person by right of ownership or several natural persons by right of joint partial ownership. However, attention should be drawn to the fact that after the Law of the Republic of Lithuania on Individual Enterprises entered into force, the individual enterprises whose owners are non-production organizations became considered as established for the period until 31 December 2004 and could be transformed, liquidated or transferred to other persons before the specified date (Tobulevičiene, 2005).

Before the individual enterprise rights as a legal entity were specified in the Law, the property of the enterprise was not separated from the enterpriser's property. Now, the enterpriser is fully liable for the obligations of the enterprise during operation and after liquidation of the enterprise. This provision was clearly specified in the Law of the Republic of Lithuania on Individual Enterprises.

However, the enterprise cannot be identified with the property of the enterprise owner which is used to satisfy their needs and the needs of their family. The enterprise assets are accounted separately by keeping the books on the enterprise operation and turnover and drawing up enterprise balance sheets. The enterprise balance does not include the private property of the enterprise owner's family. Profit tax, income tax and other taxes are paid in the name of the enterprise (Vileita, 1997).

The advantages of the individual enterprise as a business organization entity are as follows: 1) no minimum initial capital is required by laws; 2) the individual enterprise may keep accounting in a simplified way; 3) the owners of the individual enterprise may manage the enterprise by their own or together with the members of their family, i.e. they do not need to employ other people or conclude the contracts of employment with them (Free Market..., 2007).

The generalized definition of individual entities of commercial law in various foreign countries is slightly different. The commercial economic entities of this type found in the laws and commercial practice of the countries, which inherited the British legal system or in which the so called monistic (unified) civil legal system is applied (i.e. the commercial law is not separated from the civil law), are most often called sole or individual owners (in England –*sole proprietorship*, *sole trades* or *ownership*; in the U.S.A. –*individual proprietorship*; in Italy –*ditta individuale*) (Heffernan, 2006).

Two Codes –the Civil Code and the Commercial Code– are applied in the countries in which the so called dualistic civil (private) legal system, i.e. the commercial law is separated from the civil law, is applied. The entities of commercial law of this type are most often called individual entrepreneurs (Fr. *eterpreneur individuel*, *entreprise individuelle*) (Šatas, 1998).

In the U.S.A. the individual enterprise (*sole proprietorship*) is the most ordinary economic entity. The person, who has selected this type of business, and the business itself are inseparable. The individual enterprise may exist so long as it is managed by the sole enterprise owner (Uniform Commercial Code, 1964).

On comparing Lithuanian and French individual enterprises, which, however, are regulated by different legal acts, obvious similarities are observed such as the sole owner, unlimited liability, the owner is fully liable for enterprise obligations, etc.

It should be pointed out that the dualistic private legal system is also applied in the German legal system. Thus, the civil and commercial relations are regulated by separate, unified codes of laws (codes): the Civil Code and the Commercial Code. Though the legal system of the two countries is similar, the definition of the individual enterprise is quite different (Financing..., 2000).

Russia as well as Lithuania or any other post-Soviet country is conducting active publishing and improvement activities with regard to new legal acts which regulate private commercial and economic relations. However, the business organization and legal regulation acts adopted during the Soviet regime are, in contrast to Lithuania, still in force in Russia. The most important legal source is the Law on Companies and Entrepreneurship (Labutiene, 1995).

Russian individual entrepreneurs are considered to be individual natural persons who conduct private entrepreneurship without establishing a company and individual (family) enterprises of small craftsmen and traders. All Russian

economic entities of this category as well as similar entities in other countries expand commercial activities *sui juris* and at one's own risk only. Their liability for obligations and debts to creditors covers not only the part of assets apportioned for company needs but also all the other private property.

Private enterprise, long the bane of socialist propagandists, is booming in China today. Chinese industry includes 5,5 million individual enterprises that employ no more than seven workers each (Jefferson, 1999).

It should be pointed out that the Law of the Republic of Lithuania on Companies includes new provisions on protection of the enterprise participant in case the individual enterprise is established by a married person. It should be borne in mind that the individual enterprise may not be owned by spouses under joint partial ownership and a written consent of the other spouse to establish the enterprise shall be received. If such consent is not received, the individual enterprise may be established by the sole owner and only his/her individual property can be considered to be the enterprise property. The Law on Individual Enterprises provides for that the enterprise is managed by the sole management body –the individual enterprise manager (Perkumienė *et al.*, 2006).

The important bylaws governing the activities of the individual enterprise is the bylaws of the individual enterprise. This document is also considered to be the constitutive agreement.

It should also be emphasized that until now no special individual enterprise bylaws existed. The basis for establishment and operation of individual enterprises was a special application form submitted to the administration of the corresponding municipality. From the day when the Law on Individual Enterprises entered into force, each individual enterprise shall have the bylaws of the enterprise. However, this document is significantly simpler comparing to the constitutive documents of other legal entities.

Attention should be drawn to the fact that a submitted application to possess a legal entity or amendments to the documents of the individual enterprise registered in the Legal Entities Register will not always be satisfied. Should such applications not comply with the specified requirements, they will be rejected. There are cases specified in the legal acts when the Legal Entities Register officer has the right to reject to register the legal entity or amendments to the documents or data of the legal entity. Such cases have been specified and a detailed list thereof has been prepared. So other laws may not contain any other reasons for which the legal entity or the documents or alterations to the data of the legal entity could not be registered in the Legal Entities Register.

According to the provisions regulated in the Law of the Republic of Lithuania on Individual Enterprises, the individual enterprise may not be reorganized, i.e. it may not be incorporated into another legal entity, merged with another or several other legal entities, shared out to several operating legal entities or divided into several newly established legal entities.

The only case prescribed for reorganization of the individual enterprise is when the individual enterprise is inherited by a person who is the owner of another individual enterprise. In this case, the successor has the right to join one enterprise to the other or merge them. Moreover, some more cases when the individual enterprises may be (or more precisely –shall be) reorganized are prescribed in the provisions regulating the entry of the Law into force.

Thus, the main cases when the individual enterprise may be reorganized:

- when the individual enterprise owners possess two or more individual enterprises;
- when in the name of the individual enterprise both spouses are indicated as the owners.

Since the individual enterprise is recognized as a legal entity, it is liquidated on the grounds and according to the procedure of liquidation of legal persons as set forth in the Civil Code. Therefore, the general grounds related to liquidation of companies, individual enterprises and legal entities will be considered.

The grounds for liquidation of the enterprise may be:

1. the enterprise owner's decision to cease operation of the enterprise;
2. when by court decision the enterprise is recognized as an insolvent debtor;
3. the decision adopted by state institutions to cancel registration of the enterprise due to violation of law specified in the laws of the Republic of Lithuania.

The institution which has adopted the decision to cease operation of the enterprise assigns a liquidator of the enterprise or obliges the enterprise founder to perform that. After the liquidator has been assigned, the enterprise acquires the status of the enterprise in liquidation: the enterprise body loses their authorities, the functions of the enterprise body are performed by the enterprise liquidator, and the enterprise may enter only into such agreements which do not contradict the laws regulating operation of the enterprise in liquidation. The enterprise in liquidation shall be reregistered.

It is very important for the enterprise in liquidation or any other company to settle accounts with its creditors.

Meanwhile, the liability covers all assets (both enterprise and private property). Thus, claim to all property may be imposed. However, giving the veto to creditors creates opportunities to abuse creditor's rights, drag out processes or evade the law (Čiburienė, 2005).

The Law of individual enterprises had influence for variation of individual enterprises number– it decreased.

According to register of legal persons in 2010-01-01 in Lithuania were registered 58604 individual enterprises from which 16742 were functional. It made 28.6 percentages for its general number. The number of recorded individual enterprises in comparison with 2002 year decreased 32.6 percentages and in 2006 –5.7 percentages. The part of functional individual enterprises in general number of individual enterprises from 50.1 percentages in 2002 decreased till 30.2 percentages in 2007 it means 19.9 point of structure (1 table). The way of safe and effective economics and possibility for citizens to work and to earn the best shows the level of residents' enterprise. It is a number of enterprises which falls for 1000 residents.

The level of Lithuanian residents' enterprise in 2002 was 20 enterprises and this number gradually increasing. But in comparing with the overage of other E.U. countries the level of Lithuanian residents' enterprise is half less (Grižibauskienė, 2004).

In realization of attitudes of Lisbon strategies it's necessary to increase residents' enterprise and to reach the increase of economics.

Big number of individual enterprises determinates, that for their establishment is not need minimal capital, it were invoked many concessions, more simple the procedure of the establishment, less tariff of income taxes, the possibility to keep tabs in more streamlined way.

Year	Registered	In operation	Enterprises in operation					
			share %	relatives %		number per 1,000 population fixed-base (2002 = 100)	relatives %	
				fixed-base (2002 = 100)	link (previous year = 100)		fixed-base (2002 = 100)	link (previous year = 100)
2002	68,426	34,284	50.1	100	–	9.9	100	–
2003	83,017	31,860	38.4	92.9	92.9	9.2	93.3	93.3
2004	76,090	27,898	36.7	81.4	87.6	8.1	82.1	88.0
2005	74,061	25,063	33.8	73.1	89.8	7.3	74.2	90.4
2006	70,817	24,162	34.1	70.5	96.4	7.1	72.0	97.0
2007	67,362	23,106	34.3	67.4	95.6	6.8	69.2	96.1
2008	64,245	22,704	35.3	66.2	98.3	6.7	68.4	98.8
2009	62,131	20,499	33.0	59.8	90.3	6.1	62.0	90.7
2010	58,604	16,742	28.6	48.8	81.7	5.0	51.0	82.2

Source: Lithuanian Department of Statistics.



The variation of individual enterprises number determines the intensity of new enterprises registration and their in operation. When we count such type enterprises from 2001 we can see, that during the year the number of registered individual enterprises from 2004 (when came in force the Law of individual enterprises) is almost the unvarying. While the number of in operation individual enterprises from 2004 perennially decrease until the economic crisis period started in the end of 2008.

Now is more difficult to establish an individual enterprise as came in force new order due to juridical persons' registration in Register centre. Before this order the juridical persons were registered in the municipalities add they had to pay 107 LTL (1 EUR = 3, 4528 LTL). Is not too much but the Basic social benefit or Minimum Standard of Living is 130 LTL. Now all documents of each juridical subject which is going to be established should be confirmed by notary. Due to this reason the process of establishment is longer and more expensive.

The number of individual enterprises is decreasing and due to it bankrupt. In 2008 next door to bankruptcy enterprises it made 34, 7 per cent for general number of bankruptcy enterprises. In comparing with previous year it can be stated, that the number of next door to bankruptcy enterprises and failed enterprises is increasing. In 2004 in comparing to 2003 the number of next door to bankruptcy enterprises increased 22, 9 per cent., in 2005 in comparing to 2004-40, 7 per cent., in 2008 in comparing to 2007-44, 0 per cent. The initiators of bankruptcy are only 15, 3 per cent. owners of enterprises. Generally the initiators of bankruptcy are the board of social fund of insurance -39, 4 per cent. and other creditors- 12, 9 per cent.

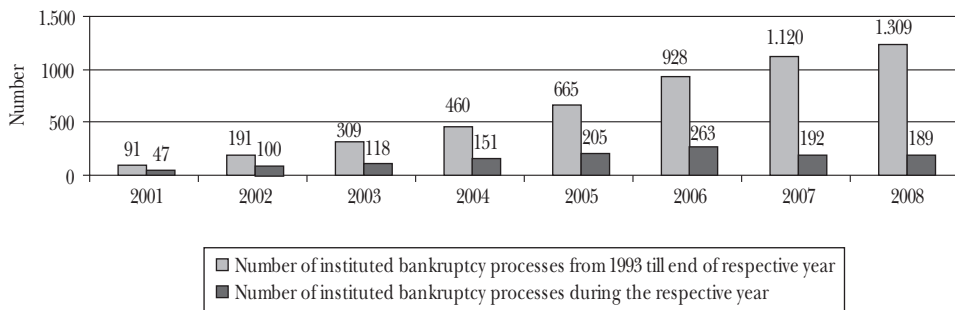


Figure 1. Individual enterprises in bankruptcy and bankrupt enterprises.

In the case of bankrupt employees suffer even enterprises are not so big. The property of next door to bankruptcy enterprises in 2008 reached about 68 per cent of creditor demands. Administrators of bankrupt uphold that increasing number of individual enterprises which owners came to abroad and left their

enterprises. There are no any laws which can obligate the owner of individual enterprise to close enterprise before leaving. It's provided only administrative liability for undeclared declarations and financial accounts. It's difficult to identify and cases when the owners initiate the case of bankrupt themselves due to big debts. In this case for the owner is better to pay the administrative then to pay debts (Pranckevicius *et al.*, 2003).

Individual enterprises mostly are small enterprises in which works the owner of the enterprise and members of his family. Even 72 per cent of all individual enterprises are such, in which a number of employees are from 1 till 5 (Figure 2).

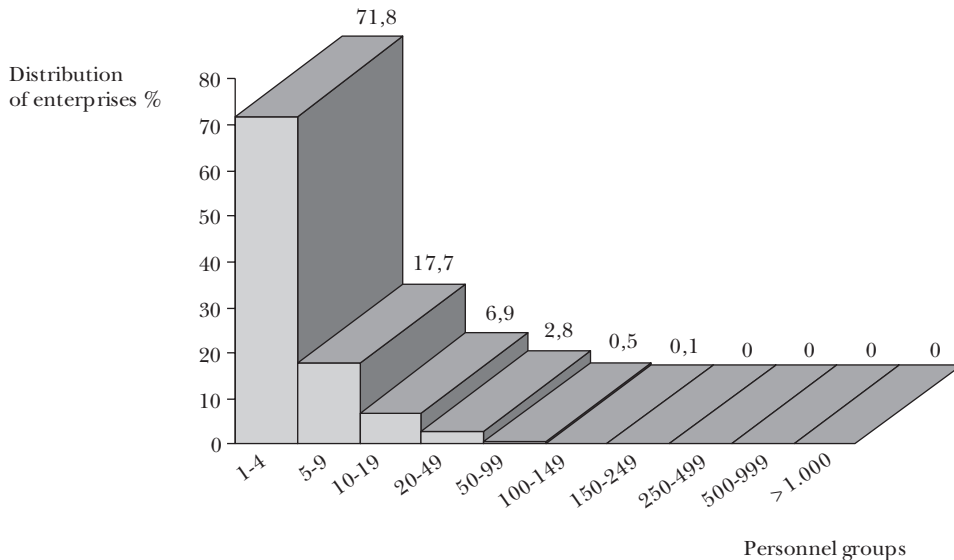


Figure 2. Distribution of individual enterprises in operation by personnel groups as 1<sup>st</sup> of January, 2009.

As we can see in figure 2, 17.7 per cent of individual enterprises a number of employees are from 5 till 10. The number of individual enterprises, where are engaged 100 and more employees is less than 0, 1 per cent.

In some E.U. countries, for example in Sweden, such kind enterprises compose till 90 per cent a number of all economy subjects and at the same time even 70 per cent of individual enterprises are enterprises of one person (Tobuleviciene, 2005).

According to types of economics activities the individual enterprises mostly manage this activity: retail trade (28,1 per cent); land transport via pipelines (9,0); sale, maintenance and repair of motor vehicles and motorcycles, retail sale

of automotive fuel (8,6 per cent); health and social work (6,4 per cent); hotels and restaurants (5,9 per cent); construction (4,6 per cent).

Individual enterprises as one of the main legal forms of enterprises create working places for its owners and employees.

### III. CONCLUSIONS

1. The Law defines the individual enterprise as a private legal entity of unlimited liability. This means that if enterprise obligations cannot be covered by the individual enterprise assets, they shall be covered by the individual enterprise owner. However, it should be pointed out that the individual enterprise acquired the rights of the legal entity only after the new Civil Code was adopted. Prior to that, the individual enterprise was not deemed to have legal entity rights. Also, this provision is of high importance for individual enterprise owners since they are fully liable for enterprise debts and outstanding obligations. Therefore, this provision is considered to be one of the strongest disadvantages and the prior reason to have the enterprise transformed into some other type of enterprises for which the extent of liability would not be so high.
2. Emphasis should be made on the fact that the present Law on Individual Enterprises indicates that the individual enterprise owner may only be the sole person. According to the previous Law on Companies, a few persons could be individual enterprise owners. The Law specifies that the individual enterprise owner may not be the owner of another individual enterprise. Thus, one person may possess only one individual enterprise.
3. The Law on Individual Enterprises provides for that the individual enterprise may be transformed into a public limited-liability company, private limited-liability company as well as a public establishment. The specified general transformation requirements as well as peculiarities of transformation into a public limited-liability company or a private limited-liability company are related to the European Union Company Law. The most popular are transformations into a private limited liability company and the main reason for that –limited civil liability.
4. The individual enterprise may not be reorganized except for the case when the individual enterprise is inherited by the person who is the owner of another individual enterprise. During the transitional period specified in the final provisions of the Law, the persons who possess two or more individual enterprises as well as the individual enterprises in whose name both spouses are indicated as the owners will be able to reorganize the individual enterprises. In the first case, such

opportunity can be considered as advantage, in the second case –as disadvantage since it overburdens the spouses.

5. The individual enterprise may be liquidated on the grounds and according to the procedure of liquidation of legal persons as set forth in the Civil Code. Only liquidation peculiarities are specified in the Law.
6. On comparing of peculiarities of Lithuanian and foreign individual enterprises, it was determined that out of all considered foreign countries most of the similarities were found between Lithuanian and American individual enterprises though some differences such as enterprise management by both spouses were detected as well.

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