

### **3<sup>rd</sup> Lesson**

#### **2.2.3 Reserves**

Reserves are values created by the company and the partners cannot (by law imposition or articles of association) or do not want to distribute.

There are several types of reserves:

##### **1- Contractual reserves – provided in the articles of association**

They are constituted by the will of the partners in the articles of association.

These reserves may have the most varied purposes. For example, they may serve for equipment modernization; purchase of facilities, inclusion in share capital, etc.

Partners can change the articles of association in order to remove the clause that provides this reserve and the value of the reserve is distributed as dividends by the partners.

##### **2- Optional or free reserves**

The partners may deliberate annually to afford part of the profits and constitute a free reserve. However only half of the profits can be for the free reserve because it's mandatory to distribute at least half of the profits for the partners.

##### **3- Legal reserves**

They are imposed by law. It's required that at the end of each year, a percentage not less than 5% of the company's profits integrate the legal reserve until its amount is at least equals to 20% of the share capital (or 2.500 euros minimum in Lda./Ltd. companies). When the reserve is fulfilled the value can be used to increase share capital and gradually restored the minimum amount of the reserve.

These reserves have the following purpose:

- Strengthening the principle of the intangibility of the share capital - the law seeks to ensure que the net asset does not fall below the amount of share capital;
- Eventually cover the part of the accused loss in the balance sheet for the year;
- Incorporation in asset - self-financing preventing the reduction of the net asset and the need for financing.

In case of violation of legal reserves:

If a deliberation disregards the legal provisions of the constitution, reinforcement or use of the legal reserves, the effect is the nullity of the deliberation.

Managers and Directors who have contributed to such deliberations may even incur in civil liability.

#### 4- Hidden reserves

It is an indirect process of not distribute dividends to the camouflage of profits and operates either by way of the undervaluation of assets, either by overvaluation of liabilities.

## **2.3 Partners rights and obligations**

### **1 - Partners Obligations**

#### **1.1 – Contribution obligation**

In the articles of association, partners subscribe a participation in the company and they compromise to pay the respective value – the payment of this value is the contribution obligation and it will define the percentage of each partner participation in the company. The breach of the obligation could lead to partners 'exclusion from society.

The contributions can be:

**-Money Contributions**

The money contributions must be accomplished at the time of conclusion of the articles of association, however the law allows that they may be held until the end of the first financial year. However the money contributions may be deferred for a period not exceeding five years. In the SA/PLC companies 70% of the value of money contributions may be deferred.

**-Contribution with goods**

They cannot be deferred. They must be clearly described in the constitutive act of the company (articles of association) and may consist in the transmission of some movable or immovable goods, including a commercial establishment, the transmission of industrial property rights, or credits transmission. They should be evaluated by a Certified Public Accountant that will assign them a value.

**1.2 - Accessory or supplementary provision obligations**

The articles of association may provide the possibility of accessory or supplementary provision obligations. These may consist in providing a service or work, to give something to the company, or to borrow some importance to the company (free or costly).

**2 – Partners Rights**

**2.1 Information Right**

The partners can obtain information about the company management and they can consult all company's documents.

The company may refuse information if there is feared that the partner could use it for strange purposes for the company or with the intention of causing damage.

However in SA/PLC companies this right is limited. It is just guaranteed a minimum right to information to the partners holding at least 1% of the share capital and only if they claim a justified reason and just for certain elements such as accounting documents or minutes.

On the other hand who individually or collectively hold more than 10% of the share capital may request information about past events, present or in process of execution or when they intended to establish liability of some company body.

The right to obtain information of the company may only be exercised by partners that represents, individually or collectively 10% of the share capital.

The partners have the right, without restriction, to the information for the preparation of General Assembly or during the reunions in this body in order to be able to make their decisions.

## **2.2 – Right to Profits**

The right to profits is a fundamental right of the partners, is one of the main causes of their participation in the company.

It is null the articles of association's clause that excludes a partner of the communion in the profits or that exempts to participate in the losses of the company.

Usually the partners participate in the profits and losses of the company according to each proportion of participation in the share capital.

There will only be distributable profit when net asset of the company exceeds the amount of share capital plus legal reserves before that there can be no distribution of any dividends or delivery of any goods to members. To such opposes the principle of intangibility of the share capital.

The profit distribution cannot be taken without a previous partner's deliberation and must be preceded by a previous approval of the annual accounts.

Partners have the right to the distribution of profits (as dividends) at least of half of the profits, unless if there is a clause of the articles of association denying it or deliberation taken by a majority of three quarters of the votes corresponding to the share capital.

## **2.1 – Right to vote**

This right consists in the possibility of the partners being present at the General Assembly, to intervene in it and vote. It is important to mention that, in public limited companies may exist partners without voting rights if they hold shares without voting so-called preference shares without voting rights, which in turn, confer the right to a priority dividend. But even these actions, if the priority dividend is not paid to the partner, for two financial years, they can exercise the right to vote. In public limited companies, the articles of association may make voting rights depending of possession of a number of shares.

If there is a conflict of interest between the partner and the company is possible to avoid the voting. Thus, the partner is prevented from voting in deliberations that fall on himself: release him from some obligation, disputes between the partner and the company, his exclusion from the company, dismissal with just cause from his administrator/director – in an PLC or manager in an Ltd.

## **2.2 – Right to be designated for the administration and supervisory bodies**

The managers (Lda./Ltd.) and the administrators/directors (SA/PLC) as well as the Supervisory body can be designated in the articles of association or elected by deliberation between partners or not partners. However the Supervisory Board should be constituted by at least one Certified Public Accountant and the rest of the members can be company partners. In the Ltd. if doesn't exist a supervisory board the supervision is made by an accountant.

## **Case Studies**

**1- What's the importance of the legal reserves in what concerns to the share capital?**

Strengthening the principle of the intangibility of the share capital - the law seeks to ensure that the net asset does not fall below the amount of share capital, this is one of the purposes of the legal reserves.

**2- On January 2, 2010 was incorporated by A, B, C the ABC - Vehicles Trade and Repair, Ltd. based in street X. Each partner owns a share of 5.000 euros.**

**a) What's the value of the share capital?**

15.000 euros, the sum of all partners' contributions.

**b) If the ABC were a PLC, would the share capital match with legal minimum?**

The minimum share capital value in a PLC is 50.000 euros.

**a) Until when can the partners fulfill the payment of the respective initial contribution? If one of the contributions was a good evaluated in XXX euros, would your answer be the same?**

The money contributions must be accomplished at the time of conclusion of the articles of association, however the law allows that they may be held until the end of the first financial year. However the cash contributions may be deferred for a period not exceeding five years. In the PLC companies 70% of the value of money contributions may be deferred. On the other end the contribution in goods cannot be deferred.

**b) If a partner does not fulfill timely his initial obligation, who would be liable for the payment?**

Due to the joint liability of each partner for all the initial contributions if one does not fulfill timely it all others are liable for fulfilling it in the proportion of the respective participation in the company. If the company was a PLC, the partners liability was limited to capital subscribed, but unlike the Lda./Ltd. they are not liable for other contributions.

- c) If the company was a PLC (with a share capital of 60.000 euros) what value could be deferred and until when?**

At least 30% of money contributions must be made in the act of incorporation. The remainder can be deferred for five years.

- d) A, B and C are responsible to the creditors in proportion to the respective participation proportion in the company?**

Only the assets of the company responds to the company's debts not the partners own assets. But, because the company is an Lda./Ltd., it is legal to stipulate in the articles of association that a partner can respond previously to the company's creditors until a certain amount.

- e) Two years after its incorporation, the company has a profit of 15.000 euros after the payment of respective taxes. May the Management propose the distribution of 10.000 euros of dividends to partners?**

To the profit shall be deducted the amount allocated to the legal reserve equivalent to 5% of the profit (750 euros). So are distributable by the partners 14.250 euros.