

Negative equity in Polish LLC

key legal consequences and possible remedial actions

ポーランド有限責任会社における資本
欠損への対応

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Introduction: types of capital companies in Polish law

Limited liability company (LLC)

- High flexibility, limited formalism
- Designated for majority of business undertakings
- Strong personal position and influence of the shareholders
- Most popular on the Polish market

Joint-stock company (JSC)

- High formalism compared with LLC and SJSC
- Designated for the largest business undertakings
- Limited personal position of the shareholders, high independence of the Management Board
- Often required to conduct activity in regulated sectors

Simple joint-stock company (SJSC)

- Highest flexibility and significantly limited formalism
- New type of entity (introduced in 2021) designated for start-ups
- Lowest capital requirements, provision of work as possible in-kind contribution

Sources of (negative) equity of the LLC

- **Sources of LLC's equity (net assets):** share capital, supplementary capital, reserve capitals, profits, losses and other sources specified in legal provisions.
- **Negative equity:** value of LLC's net assets < value of LLC's obligations; LLC's potential obligation to undertake protective measures if specific statutory prerequisites are met (subject to assessment of each case).

Crucial sources of LLC's equity

Share capital:
basic capital created from funds contributed by shareholders in exchange for shares

Supplementary capital:
accessory capital created i.a. from surplus of shares' coverage value over nominal value

Reserve capital:
accessory capital created i.a. from accumulated profits and additional payments

Other sources:
e.g. profits, losses, write-offs on profit, revaluation fund

Most common sources of LLC's negative equity

Obligations towards business partners

Loans granted by LLC's shareholders

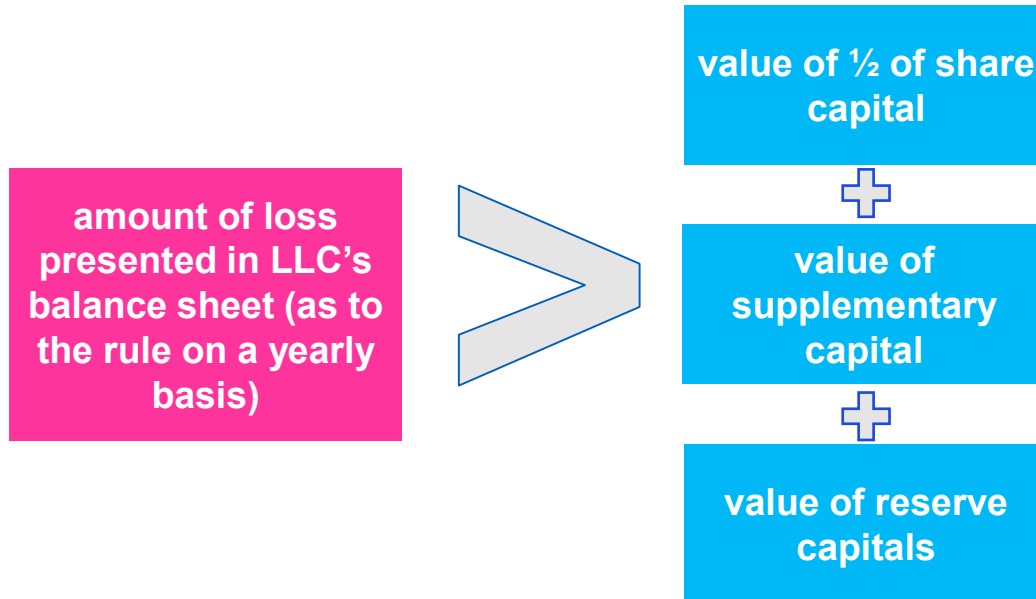
Limited liquidity resulting from late payments of receivables

Other losses generated during LLC's business activity

Negative equity: key legal risks from perspective of the LLC

- Necessity of adopting a **resolution on further existence** of the LLC by the Shareholders' Meeting convened by the Management Board without undue delay (Article 233 of the Commercial Companies Code).
- Management's Board **obligation to file for bankruptcy** of the LLC (only in some cases, financial situation of the company needs to be monitored on regular basis); risk that bankruptcy is filed by LLC's creditor.

Resolution on further existence of the LLC



Bankruptcy prerequisites (disjunctive)

Liquidity prerequisite:
LLC's incapability of fulfilling its monetary obligations
(presumed if payment delay exceeds 3 months)

Equity prerequisite:
value of monetary obligations > value of assets
(if such situation persists for at least 24 months)
exception: as to the rule, LLC's obligations to shareholders are not included

Negative equity: liability of LLC's Management Board Members

Civil liability for material damages and obligations

Towards LLC:
for damages caused by failure to convene the Shareholders' Meeting without undue delay (violation of Article 233 of the CCC)

Towards creditors of LLC:
joint personal liability for LLC's obligations if enforcement against the LLC is ineffective (exception: timely filing for bankruptcy)

Administrative liability

Failure to convene the Shareholders' Meeting – violation of Article 233 of the CCC:
fine imposed by the registry court

Criminal liability

Failure to file for bankruptcy:
fine, restriction of liberty, imprisonment or prohibition of business activity/ managing affairs of business entities (imposed by criminal court)

If negative equity results from violation of Business Judgement Rule, there is a risk of additional civil and criminal liability.

Negative equity: potential remedial actions

01

Increase of share capital:

- most standard reduction of LLC's loss-to-assets ratio
- may be conducted by AoA amendment or without it (to a limited extent)
- debt-to-equity swap as specific type of share capital increase.

02

Additional payments of the shareholders:

- simplified procedure compared with share capital increase (applicable only if AoA so provides)
- payments are made proportionally to the number of shares
- return possible if payments are not required to cover annual losses.

03

Contractual measures (improving business credibility):

- financial guarantee from a bank or insurance company
- surety contract with LLC's related entity
- contract on debt accession.

04

Generating profit from LLC's future activity:

- insecure and time-consuming compared with other remedies
- not recommended if the amount of losses is substantial.

How can we help?

01

Designing optimal legal solutions in relation to negative equity of commercial companies

02

Complex support in implementation of chosen option of neutralizing the negative equity

03

Contractual advisory, conducting negotiations with business partners

04

Representation of commercial companies before courts and state authorities

Thank You



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