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Alternatives to bring company's net assets into compliance with legislation based on Estonian examples

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Abstract. A situation may arise as a consequence of the realisation of the external and/or internal risks of a company in which the net assets of a company no longer comply with the requirements laid down by law. Net assets of a company that are not in compliance with legislation represent a situation where the liabilities of a company exceed its assets. Such a situation may threaten the sustainability of a company and its ability to meet the liabilities to its creditors.According to Estonian legislation, income tax is imposed on the refund of monetary contributions made to cover losses. Income tax is also imposed on the reconstitution of a proprietary loan as a company's liability. Income tax is imposed on both described transactions because of the fact that in the case of these transactions, net assets are brought into compliance with requirements by means of an income statement and income tax is imposed on the later disbursement of any profit distributed.The purpose of the current paper is to compare different methods for bringing a company's net assets into compliance with requirements laid down by law in the fastest and most cost effective way.The use of an additional reserve fund to comply with the requirements established by the company's net assets allows for achieving the desired result within a minimum amount of time. Monetary payments made from additional reserve fund and/or reconversion of liabilities cannot be construed as profit allocations and, therefore, such payments are not subject to income tax.

Key words: financial innovation, net assets, equity, additional fund, agricultural entrepreneur

INTRODUCTION

The changes that took place in the global economy in 2008–10 have widely caused the deterioration of the economic results of companies; Estonia is no exception to the rule and, therefore, the net assets of a company are often found to be in non-compliance with legal requirements. According to the effective legislation of the Republic of Estonia, the net assets of a public limited company must amount to at least half of the value of its share capital or 25,000 Euros, as a minimum. In the case of a private limited company, the same requirement is also valid; in monetary terms, this means that the value of net assets must be at least 2,500 Euros (Commercial Code…, 1995).

It is the duty of a management board of a company to observe the economic situation of the company and ensure its profitability and sustainable development. Should the economic condition deteriorate, the management board must immediately notify the senior management and take measures to improve the economic situation and bring the net assets of the company into compliance with legal requirements. At present in Estonia, it is possible to use either monetary contribution to cover a company's losses, waiving a proprietary loan (should a company have such a loan) or to increase the share or stock capital to bring the net assets into compliance with legal requirements.

For a company, compliance with the net assets requirement becomes an issue upon the drafting and submission of annual accounts – but not only then. During the financial year, the management of a company will be required to promptly notify its supreme management body and shareholders of the material deterioration of the company's economic situation and other material circumstances that are related to the company's business. The material deterioration of the company's economic situation may, under certain circumstances (lack of spare equity to compensate for loss due to the material deterioration of the company's economic situation), result in a net assets value that does not comply with the requirements laid down by law. This means that a company has to adopt measures – even in the middle of a financial year – to meet the requirements that are established for net assets (Commercial Code…, 1995). The non-compliance of net assets may be a result of cyclical business or manufacturing activities; agricultural production may be given here as the most characteristic example.

Apart from the substantial activation of sales efforts and saving on expenses, etc., shareholders/participants of a company can make a monetary contribution to make up for losses or increase/decrease share or stock capital, once the material deterioration of the company's economic situation has taken place. If there is no dire need to involve financial funds, the waiver of the proprietary loan can be considered as one of the possible alternatives for meeting the requirements that are established to net assets.

If monetary contributions and the waiver of proprietary loan are used, the company is obtaining revenues as a consequence of its regular business and it is then impossible to give tax-free refunds. Contributions that are made to increase share or stock capital can be refunded – under a tax-free arrangement – by decreasing share or stock capital by the same value, but this involves notary transactions and additional spending; the process is also highly time consuming.

Estonian legislation does provide an explicit definition; however, additional funds can be used to meet the requirements that are established to net assets by law, without such contributions or transactions being taxable once contributions are refunded or some of the transactions will be re-converted by a company (Vutt, 2010). The study on financial innovation discussed in this article provides an overview – using the Estonian example – of alternatives that are available to trading companies for solving issues arising from the non-compliance of net assets.

Several scientists have studied the reasons and effects of the adoption of innovative funding methods by companies. Changes that are brought on by regulations are linked to the adoption of new funding measures and as an incentive for stimulating financial innovation. Kane (1986) identified what he calls the ‘regulatory dialectic’ as a major source of innovation. Jagtaiani, et al., (1995), who studied the implementation of innovations provided by law, failed to find that changes in capital requirements consistently affected the speed of adoption of certain innovations, such as off-balance sheet products. White (2000), Pouncy (1998) and Russo & Vinciguerra (1991) have developed the academic debate on regulation: whether regulation has stimulated or impeded innovation and whether regulation is ‘sensible’ in light of innovation.

Both government taxation policies and law have an equally facilitating influence on financial innovation. However, there’s always a dilemma between measures and funding schemes that are permitted or prohibited by law. According to business financing rules, each entrepreneur should only use the funding measures that are most becoming to the structure of such assets and will substantially help to improve business. Should a company adopt new financing schemes and these are suitable – considering fundamental aspects – and also acceptable for analysts and rating agencies, there will be no objections. There are serious dangers if a company uses schemes that are not justified at a fundamental level and are merely adopted to use gaps inlegislation to define loan capital and equity. This may turn against the owners of a company who adopted such a decision, and they may also cause problems for small shareholders who weren’t necessarily even aware of such ‘scheming’.

For the majority of entrepreneurs, it is a challenge to adopt instruments that would allow for making the most of taxation advantages, while offering alternatives for coping with requirements established to equity (net assets) with respect to the minimum requirements. The majority of taxation systems have established different taxation rates (corporate and individual income tax, taxation of interests and dividends, taxation of capital and labour, residents and non-residents, etc.) and, therefore, according to a modern theory (practitioners have proven this long ago), there is an opportunity to use financial transactions to transpose assets from one form or sphere or even beneficiary to another form and type. The main purpose is to be taxed according to the lowest possible rate. Such transformations will inevitably involve expenses and expenses have the tendency to grow to a level that would still ensure the profitability of the process.

Changes in taxation rates also spur new innovations. Every vital innovation can be recognised by the extent to which it helps the user to save on taxes. The significance of financial innovation is widely recognised. Many leading scholars, including Miller (1986) and Merton (1992), have highlighted the importance of new products and services in the financial arena. The introduction of innovative instruments has allowed companies to grow their capital and cut expenses.

Previous studies mentioned here were focused on funding a company's equity. There is no discussion about alternative measures and costs of such measures to bring a company's net assets into compliance with legislation.

According to a study conducted by the audit office BDO Eesti AS, compliance with net asset value requirements is mandatory for the trading companies of several European Union Member States and third countries, and there are also EU member states where such a requirement is not applied. Based on the information provided in this study, trading companies are required to comply with the net assets requirement in Estonia, Austria, Germany, Finland, Sweden and Norway. Denmark is one of the countries participating in the survey in which the net assets requirement is not laid down by law; the same is true for Latvia (Annus, et al., 2011 a).

The purpose of this study is to give an overview of the methods based on the legislation effective in the Republic of Estonia, for bringing the non-compliant net assets of a company into conformity with requirements or up to a level required by law, using either: 1) monetary contribution or waiver of a proprietary loan, 2) increasing/decreasing share or stock capital and 3) additional reserve fund as a part of a company's equity.

MATERIALS AND METHODS

Comparative analysis and empirical analysis are used as research methods and the following tasks have been established for the study: 1) explanation of legal and administrative proceedings, accompanying monetary contribution orwaiver of a proprietary loan, increasing/decreasing share or stock capital and using an additional reserve fund as a part of a company's equity, 2) comparison of the efficiency and rate of charge of the aforementioned measures for the purposes of the operative management of a company.

RESULTS AND DISCUSSION

Monetary contribution orwaiver of a proprietary loan

The owners of a company can make a **monetary contribution** to the bank account of a company in an amount that would bring the net assets of a company into compliance with the requirements laid down by law (economic transaction no. 1). When would it be expedient to decide in favour of a monetary contribution instead of a waiver of a proprietary loan? A monetary contribution is, compared to the waiver of a proprietary loan, expedient and necessary if problems with meeting the cash requirements of a company incur simultaneously with the non-compliance of net assets. Table 1 includes a simplified balance sheet of a company, where the non-compliance of the company's net assets is compared to legal requirements on the date for preparing the balance sheet. In the given case and using the information given in Table 1, the value of net assets should be a minimum of 2,500 Euros.

According to economic transaction no. 1, owners have made a **monetary contribution** in the amount of 4,500 Euros to the bank account of the company **to compensate the losses**. For more specific identification of the payment of the monetary contribution to the bank account, it would be reasonable to give 'Contribution to compensate for losses' as the details of the payment. In the given case, accounting entry no. 1 has been used as the grounds for making the respective records in the accounting ledgers, while the assets of the company have increased from 50,000

Table 1. Simplified balance sheet of the company (in Euros) before economic transaction no. 1.

ASSETS		
	Cash in bank	50,000
TOTAL ASSETS		**50,000**
TOTAL LIABILITIES (LIABILITIES AND EQUITY)		
LIABILITIES		52,000
EQUITY		
	Share (stock) capital	2,500
	Legal reserve	250
	Profit (loss) of the reporting period	-4,750
TOTAL EQUITY/NET ASSETS		-2,000
TOTAL LIABILITIES		**50,000**

Economic transaction no. 1. Owners' monetary contribution in the amount of 4,500 Euros to compensate the losses.
Accounting entry no. 1.

D:	Bank account	4,500
K:	Miscellaneous business revenues	4,500

Euros to 54,500 Euros, or by 4,500 Euros. As a consequence, the loss in the financial period has dropped to 250 Euros due to the increase of miscellaneous business revenues, while net assets have increased and now amount to 2,500 Euros (see the balance sheet below, Table 2.), as a consequence of economic transaction no. 1.

In the given example, the non-compliant net assets of a company have been brought into compliance by decreasing the loss using an increase of miscellaneous business revenues, which were, in turn, incurred by monetary contribution to compensate for the losses. Therefore, the monetary contribution made by owners will minimize the loss and, in the given situation, loss in the amount of 250 Euros will be incurred as part of equity. Equity can be categorised as follows, depending on its nature:

- Tied-up equity, which is made up of contributions by owners and allocations from profit (restrictions apply to the disbursement of contributions to tied-up equity to owners; this is done, above all, to protect the interests of creditors);
- Free equity (or equity that can be distributed), which is mostly accumulated in the due course of regular business.

Owners who have granted the company a proprietary loan (Table 1.) can also bring the net assets into compliance with established requirements by **waiving the proprietary loan** in an amount which would bring the net assets into compliance with established requirements. The waiver of proprietary loan – should it exist as a liability of the company – is expedient if a large amount of financial means will be needed for the cash performance of the company's liabilities, which arise from the regular business of the company.

Table 2. Simplified balance sheet of the company (in Euros) after economic transaction no. 1.

ASSETS		
	Cash in bank	54,500
TOTAL ASSETS		**54,500**
TOTAL LIABILITIES (LIABILITIES AND EQUITY)		
LIABILITIES		52,000
EQUITY		
	Share (stock) capital	2,500
	Legal reserve	250
	Profit (loss) of the reporting period	-250
TOTAL EQUITY/NET ASSETS		2,500
TOTAL LIABILITIES		**54,500**

Economic transaction no. 2. Owners' waiver of proprietary loan that is granted to the trading company in the amount of 4,500 Euros
Accounting entry no. 2.

D:	Loan commitments	4,500
K:	Miscellaneous business revenues	4,500

In the case of economic transaction no. 2, the owner(s) have adopted a resolution to **decrease the proprietary loan** by the amount of 4,500 Euros. In the given case, accounting entry no. 2 has been used as the grounds to make the respective records in accounting ledgers, while the liabilities of a company have decreased from 52,000 Euros to 47,500 Euros, or by 4,500 Euros. As a consequence, the loss in the financial period has dropped to 250 Euros due to the increase of miscellaneous business revenues, while net assets have increased and now amount to 2,500 Euros (see the balance sheet below, Table 3), as a consequence of economic transaction no. 2.

In the given example, the non-compliant net assets of a company have been brought into compliance with the established requirements. This is due to decreasing the loss, using an increase of miscellaneous business revenues. Therefore, the waiver of the proprietary loan that is granted to the company by its owner will incur miscellaneous business revenues, which equal the amount of the waived loan, and the loss will be minimized. The given example represents the generation of a loss of 250 Euros and the company's equity and net assets are 2,500 Euros.

According to the estimates, refunds of contributions made by owners to compensate for the losses and waiver of the proprietary loan will most likely be taxable in the full amount, above all, because of the fact that such contributions or waiver of a loan will be dissolved into the returns gained from miscellaneous business and, therefore, it would be very easy to contest the links between the disbursed amounts and

Table 3. Simplified balance sheet of the company (in Euros) after economic transaction no. 2.

ASSETS		
	Cash in bank	50,000
TOTAL ASSETS		**50,000**
TOTAL LIABILITIES (LIABILITIES AND EQUITY)		
LIABILITIES		47,500
EQUITY		
	Share (stock) capital	2,500
	Legal reserve	250
	Profit (loss) of the reporting period	-250
TOTAL EQUITY/NET ASSETS		2,500
TOTAL LIABILITIES		**50,000**

original contributions. According to the legislation effective in Estonia, a resident company shall pay income tax on the portion of payments made from its own capital upon reduction of the share capital or contributions, upon redemption or return of shares or contributions (hereinafter holding) or in other cases, and on the portion of the paid liquidation distributions that exceed the monetary or non-monetary contributions paid into the company's capital (Income Tax Act…, 1999). As in the case of the economic transactions described above, there are no conditions referring to the Income Tax Act that would serve to diminish tax risks; any payments made to owners would be taxable as expenses not related to business activities (under the Income Tax Act), even if the net assets, which are not compliant with the established requirements, would be covered by later profit generated from the business.

Increasing share or stock capital

If the net assets of a private limited company are less than one-half of the share or stock capital, or less than the amount of share or stock capital specified in the law or another minimum amount of share or stock capital provided by law, the shareholders shall decide on a reduction or increase of share or stock capital on the condition that the net assets would thereby form at least one-half of the share or stock capital and at least the share or stock capital specified by law or other minimum capital provided by law (Commercial Code…, 1995).

According to the legislation in place in Estonia, changing the value of share or stock capital is an issue that falls into the competence of shareholders and participants. Therefore, bringing the net assets of a company into compliance with requirements laid down by law, using either increasing or decreasing of share or stock capital, will start – procedure-wise – with the adoption of an appropriate decision by the share or stock holders.

A general meeting of share or stockholders will be convened by the management. If all the shares or stock in a company belong to a single natural person, it will take approximately ten days for a sole shareholder or stockholder to adopt the appropriate decision to increase or decrease share or stock capital and have the respective entry registered in the Commercial Register, while observing all the legal requirements. However, if shares or stock of a company belong to several natural persons or legal entities and the enterprise is a limited company registered on the stock market, it may take up to sixty-five days, observing all the legal requirements, for shareholders or stockholders to adopt the appropriate decision to increase or decrease share or stock capital and have the respective entry registered in the Commercial Register (Kink et al., 2010).

In the following example, economic transaction no. 3, the increasing of share or stock capital has been used to bring net assets into compliance with the established requirements. Table 1 shows that in the given situation the value of net assets amounts to -2,000 Euros. Share or stock capital needs to be increased by 6,500 Euros (Table 4) to bring net assets into compliance with the established requirements.

Economic transaction no. 3. Increasing the shareholders' equity to 6,500 Euros
Accounting entry no. 3.

D:	Bank account	6,500
K:	Share or stock capital	6,500

Table 4. Simplified balance sheet of the company (in Euros) after economic transaction no. 3.

ASSETS		
	Cash in bank	56,500
TOTAL ASSETS		**56,500**
TOTAL LIABILITIES (LIABILITIES AND EQUITY)		
LIABILITIES		52,000
EQUITY		
	Share (stock) capital	9,000
	Legal reserve	250
	Profit (loss) of the reporting period	-4,750
TOTAL EQUITY/NET ASSETS		4,500
TOTAL LIABILITIES		**56,500**

One important moment should be considered when increasing share or stock capital. Namely, as we compare increasing share or stock capital to monetary contribution, whether to compensate for the losses or contribute to the additional reserve fund, the monetary expenses of shareholders or stockholders will be somewhat larger. For example, as we observe economic transaction no. 1, where the net assets are -2,000 Euros, the monetary expenses of a shareholder or stockholder amount to 4,500 Euros. When increasing share or stock capital in the case of net assets with equivalent value, however, the monetary expenses of a shareholder or stockholder total 6,500 Euros – in other words, they are bigger by 44% in the given example. It is important to observe that the net assets will amount to at least one half of the share or stock capital (Table 4.). When increasing share or stock capital in a lower amount, such as by 4,500 Euros, the value of the share or stock capital will be 7,000 Euros while the value of positive net assets will amount to 2,500 Euros, but this will not be in compliance with the requirement of net assets amounting to at least a half of the value of share or stock capital.

Decreasing share or stock capital

Considering the legislation in place in Estonia, decreasing the share or stock capital to bring net assets into compliance with the established requirements has no immediate effect, according to the authors of this article, and such a practice will not produce the desired result: net assets that meet the established requirements.

An additional reserve fund as part of a company's equity

Legislation of the Republic of Estonia does not give any explicit and unambiguous provisions for the establishment of an additional reserve fund;only general principles are given. As for private limited companies, some references for the opportunity of the establishment of such a fund is given in the Commercial Code § 176 (1^1) and in the case of public limited companies, in the Commercial Code § 301 (1^1), which state that owners can adopt **other measures** in the case of non-compliant net assets (Commercial Code…, 1995). One of the possible measures in the given case could be, according to the balance sheet scheme, specified in Exhibit 1 to the Accounting Act, the establishment of miscellaneous additional funds as a part of equity (the Accounting Act…, 2002). It will then be possible to open a synthetic account - "Additional funds" - in the chart of accounts of an accounting entity. If an accounting entity has opened a synthetic account - "Other funds" - which is used according to the requirements laid down in the appropriate rules of procedure of the accounting entity, such a synthetic account can be linked to an analytical account- "Additional funds" - which will be used in accordance with the additional internal regulating documents of the company. For the established additional reserve fund to have the parameters of equity, the rules of its establishment and use must be laid down in the Articles of Association of the company concerned (Commercial Code…, 1995). What are the important aspects that should be emphasised in the regulative documents of a company and only marked as little as possible to avoid situations where payments made from additional funds will be later construed as amounts subject to income tax? It's important to indicate, in regulative documents, that monetary or non-monetary contribution to establish/increase the additional reserve fund must be transferred to a company and interests must not be calculated on this amount (Annus, et al. 2011 b).

The following must at least be specified in one of the most important regulative documents – Articles of Association – of a company:

1. A company may establish additional reserve funds, without fixed minimum and maximum value, as a part of equity. Additional funds are meant to comply with the net assets requirements established to the company by law, and this can be used with a resolution of the general meeting of shareholders/stockholder or under authorities granted to the management board with a resolution of the general meeting:
   - 1.1. For (re)conversion of loans to shareholders/stockholders refunding a monetary or non-monetary contribution, provided that the value of net assets of company shall not drop below the permissible minimum level provided by law, as a consequence of refunding and/or reconversion of a monetary or non-monetary contribution;
   - 1.2. To compensate for the losses, if this cannot be compensated on the account of the company's profit brought forward and the mandatory legal reserve;
   - 1.3. To increase share or stock capital by fund emission;

2. Monetary or non-monetary contribution for establishing/decreasing an additional reserve fund must be transferred to the company and interests must not be calculated on this amount.
3. An additional reserve fund can only be increased or decreased with a resolution of the general meeting of the shareholders/stockholders or under authorities granted to the management board with a resolution of the general meeting.
4. Non-monetary contribution to the additional reserve fund will be valued by the management board and evaluation will be checked by an auditor only with a resolution of the general meeting of shareholders/stockholder.

Below, you will find some examples of the establishment of an additional reserve fund and bringing net assets into compliance with the established requirements, using the **waiver of a proprietary loan** and **monetary contribution** (Tables 1–5). Using the waiver of a proprietary loan for bringing net assets into compliance with the established requirements is demonstrated by means of economic transaction no. 4. In the given case, the waiver of the proprietary loan – should it exist as a liability of the company – is also expedient if a large amount of financial means will be available for cash performance of the company's liabilities, which arise from the regular business of the company.

Economic transaction no. 4. Owners' waiver of proprietary loan granted to the trading company in the amount of 4,500 Euros
Accounting entry no. 4.

D:	Loan commitments	4,500
K:	Additional funds	4,500

In the case of economic transaction no. 4, the owner(s) have adopted a resolution to **decrease the proprietary loan** by the amount of 4,500 Euros. In the given case, accounting entry no. 4 has been used as the grounds to make the respective records in the accounting ledgers, while the **liabilities** of a company **have dropped** from 52,000 Euros to 47,500 Euros, or by 4,500 Euros. As a consequence, the additional reserve fund has increased by 4,500 Euros during the reporting period. As a final result, the value of net assets that do not comply with the requirements have increased, amounting to 2,500 Euros (see the balance sheet below) as a consequence of economic transaction no. 4, and they now meet the established requirements.

Table 5. Simplified balance sheet of the company (in Euros) after economic transaction no. 4.

ASSETS		
	Cash in bank	50,000
TOTAL ASSETS		**50,000**
TOTAL LIABILITIES (LIABILITIES AND EQUITY)		
LIABILITIES		47,500
EQUITY		
	Share (stock) capital	2,500
	Legal reserve	250
	Additional funds	4,500
	Profit (loss) of the reporting period	-4,750
TOTAL EQUITY/NET ASSETS		2,500
TOTAL LIABILITIES		**50,000**

The following example deals with bringing the net assets of the company into compliance with the established requirements by making a **monetary contribution** by the owner(s) to the company's bank account. The transaction is characterised by Tables 1, 6 and economic transaction no. 5. Monetary contribution, compared to waiver of a proprietary loan, is rather relevant for the given example, if non-compliance of net assets will also mean problems with meeting the cash requirements of a company and additional funds are needed.

Economic transaction no. 5. Owner(s)' monetary contribution to an additional reserve fund in the amount of 4,500 Euros
Accounting entry no. 5.

D:	Bank account	4,500
K:	Additional funds	4,500

According to economic transaction no. 5, the owners have made a **monetary contribution** in the amount of 4,500 Euros to the **additional reserve fund** of the company. In the given case, accounting entry no. 5 has been used as the grounds to make the respective records in accounting ledgers, while the assets of a company have increased from 50,000 Euros to 54,500 Euros, or by 4,500 Euros. As a consequence of the transaction, the additional reserve fund has increased by 4,500 Euros during the reporting period. Net assets that do not comply with the established requirements have increased as a consequence of the increase of the additional reserve fund by 4,500 Euros (see the balance sheet below).

Table 6. Simplified balance sheet of the company (in Euros) after economic transaction no. 5.

ASSETS		
	Cash in bank	54,750
TOTAL ASSETS		**54,750**
TOTAL LIABILITIES (LIABILITIES AND EQUITY)		
LIABILITIES		52,000
EQUITY		
	Share (stock) capital	2,500
	Legal reserve	250
	Additional funds	4,500
	Profit (loss) of the reporting period	-4,750
TOTAL EQUITY/NET ASSETS		2,500
TOTAL LIABILITIES		**54,500**

As there is no uniform regulation for the taxation of business revenues at European Union level and in relation to third countries, it is important to know, when comparing the taxation of consumption, what the taxation objects in different EU member states are when taxing revenues and which payments are taxable by income tax. According to the Income Tax Act applicable in Estonia, regulators assume, for the purpose of taxation, that only payments and expenses that are made of profit earned and distributed in due course of business and payments not linked to business will be taxable. By engaging in unambiguous activities and using correct documentation, it is possible to avoid, upon the use of additional reserve fund, ill-intended situations of payments made of reserve fund capital as profit allocations. As a claim established by shareholders/stockholders is the basis for the foundation of an additional reserve fund (an earlier loan/monetary contribution) against the company or monetary contribution to the company's bank account or deposit box, which can be verified with the appropriate documents (contracts, bank account statements, income receipts, etc.), the non-taxation requirements set by the regulator have been met. Transparency of the economic transaction and activities of the parties involved for the purposes of documenting contributions and payments also play an important role in meeting the non-taxation pre-requisites. Therefore, to eliminate any possible tax liability risk upon the payment of contributions made to an additional fund and/or reconversion of a proprietary loan, it's important to show with the transaction, as clearly as possible, the links between the contribution and/or decreased loans and payments.

An overview is given in Table 7 of the comparison of the efficiency and expenses related to the legal and administrative proceedings accompanying a monetary contribution-waiver of a proprietary loan, share or stock capital and additional reserve fund, which form a part of a company's equity for the effective management of a company.

When comparing the methods used to bring net assets, which fail to meet the requirements, into compliance with law, it transpired that the monetary contribution or waiver of proprietary loan both allow for bringing net assets into compliance with law.Both proceedings require a minimum amount of time, are operative and no additional expenses are required to achieve the desired result. The proceedings also represent a considerable disadvantage – the outcome will be achieved by increasing miscellaneous business revenues. This will result in a decrease of a company's loss and the net asset's value will reach the limit provided by law. Refund or reconversion will be regarded as transactions that are subject to income tax, in the case of both proceedings.

Increasing share or stock capital, being one of the alternatives for bringing net assets value up to the required level, is very time consuming and procedurally, document intensive. However, as we compare increasing share or stock capital to monetary contribution, the monetary expenses of shareholders or stockholders will be somewhat larger. In conducting this study, we concluded that the total monetary expenses of a shareholder or stockholder are bigger by 44%, compared to the monetary contribution to the reserve fund. The further decreasing of share or stock capital will result in time and money requirements, which are equivalent to those that accompany the increase of share or stock capital.

Considering the legislation effective in Estonia, decreasing the share or stock capital to bring net assets into compliance with the established requirements has no immediate effect, according to the authors of this article, and such a practice will not give the desired result – net assets that meet the established requirements.

The use of additional reserve funds to comply with the requirements established to a company's net assets allows for achieving the desired result in a minimum amount of time. To avoid any extra time spent on modification of the Articles of Association once problems arise, it would be reasonable to include the required provisions in the Articles of Association earlier. Monetary payments made from an additional reserve fund and/or reconversion of liabilities cannot be construed as profit allocations and, therefore, such payments are not subject to income tax. As a result, to eliminate any possible tax liability risk upon the payment of contributions made to the additional fund and/or reconversion of proprietary loan, it's important to show along with the transaction, as clearly as possible, links between the contribution and/or decreased loans and payments.

Table 7. Comparison of Proceedings.

No.	Proceedings	Taxation risk upon payment/refund	Time requirement /operative approach	Expenses related to official approach	Other material comments
1.	Monetary contribution-waiver of proprietary loan	Yes	Minimum time requirement Operative solution	No	
2.	Increasing share or stock capital	No	Linked to working hours of notaries Not very operative, requires lots of time	Yes	Monetary contribution to share or stock capital will be somewhat larger than in proceedings specified in section 1 or 4 of this Table
3.	Decreasing share or stock capital	Considering the legislation in place in Estonia, decreasing the share or stock capital to bring net assets into compliance with the established requirements has no immediate effect, according to the authors of this article.			
4.	Additional funds	No	Minimum time requirements. Operative solution. Requires amendment of Articles of Association, if the regulation is not provided by the Articles of Association	Minimum; single expenses if Articles of Association are modified	

CONCLUSIONS

Due to the cyclical nature of the economy and as a consequence of business failure or taking unreasonable business risks, a situation may incur in which the company’s net assets no longer comply with the established requirements. For a company, characteristically, compliance with the net assets requirement becomes an issue upon the drafting and submission of annual accounts, but not only then. During the financial year, the management of a company will be required to promptly notify its supreme management body and shareholders of the material deterioration of the company’s economic situation and other material circumstances that are related to the company’s business. The material deterioration of a company’s economic situation may, under certain circumstances, result in the value of net assets which does not comply with the requirements. Non-compliance of net assets may also result as a consequence of cyclical business or manufacturing activities; agricultural production may be given here as the most characteristic example.

Scientists have studied different methods of funding the net assets of companies. However there is no discussion about the measures to be taken when a company's net assets do not meet the established requirements.

Based on Estonian example there are three different effective methods to bring a company's net assets into compliance with the established requirements. The three effective methods areas follows: 1) monetary contribution or waiver of a proprietary loan, 2) increasing/decreasing share or stock capital and 3) establishment of an additional reserve fund as a part of a company’s equity

The fastest method is a monetary contribution or waiver of a proprietary loan. The given method decreases the loss by increasing miscellaneous business revenues and brings net assets to meet the established requirements. A monetary contribution is, compared to the waiver of a proprietary loan, expedient and necessary if problems with meeting the cash requirements of a company occur simultaneously with the non-compliance of net assets. Refunds of contributions made by owners and a waiver of the proprietary loan to compensate for the losses will most likely be taxable in the full amount.The method in which refunds are not taxable would be increasing share or stock capital, which increases the company's net assets and brings them to meet established requirements. The negative side of that method is that it is time consuming and the monetary expenses of a shareholder or a stockholder are 44% larger, compared to monetary contribution, waiver of aproprietary loan or establishment of an additional reserve fund.

Establishment of an additional reserve fund is the fastest method to bring the company's net assets to meet established requirements, and refunds are not taxable. The given method diminishes the negative effect of losses to the company's net assets. For more explicit identification of the additional reserve fund function, it must be stated explicitly in a company’s Articles of Association that the company may establish additional reserve funds, without fixed minimum and maximum value, as a part of equity. It is also important to indicate, in the Articles of Association, that monetary or non-monetary contributions to establish/increase the additional reserve fund must be transferred to a company and interests must not be calculated on this amount. Additional funds are meant to comply with net assets requirements established to the company by law, and they can be used, with a resolution of the general meeting of shareholders/stockholders or under authorities granted to the management board with a resolution of a general meeting, for the (re)conversion of loans to shareholders/stockholders and refunding monetary or non-monetary contribution, provided that the value of net assets of the company shall not drop below the permissible minimum level provided by law, as a consequence of refunding and/or reconversion of monetary or non-monetary contribution. An additional reserve fund can only be increased or decreased with a resolution of the general meeting of shareholders/stockholders or under authorities granted to the management board with a resolution of a general meeting. A non-monetary contribution to the additional reserve fund will be valued by the management board and evaluation will only be checked by an auditor with a resolution of the general meeting of shareholders/stockholders.

Methods described in this article should be used in situations in which shareholders/stockholders have a clear vision for helping the company out of any difficulties, and this is economically expedient. Should the structure of a company's assets and/or liabilities indicate that the assets include items, which, once sold, would not meet the value specified in the financial statements, or liabilities have a structure that makes their refunding impossible, or economic difficulties have a long-term character and their liquidation would be unreasonably expensive, it is probably reasonable to exercise other lawful measures for either re-organisation or dissolution of the company.

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