

## **Hidden distribution of profits and other own resources in business corporations**

### **Abstract**

Hidden distribution of profits and other own resources in business corporations are an unforeseen and undesirable phenomenon under corporate law that can lead to harm not only to the creditors of the business corporation, but also to some, especially minority, shareholders of the business corporation. The subject of this thesis is thus examining how hidden distribution of profits and other own resources in business corporations is approached by the Czech legal system and what consequences are associated with the use of this method of distribution of assets from a business corporation.

Until 2021 the Czech legal system did not contain an explicit rule prohibiting hidden distribution of profits and other own resources from business corporations. However, such a prohibition can be inferred from the imperative nature of the legal norms governing the procedure of distribution of profits and other own resources from business corporation and from the general prohibition of circumvention of the law. In 2021, it became the provision of Section 40(5) of the Czech Business Corporations Act, which explicitly prohibits the provision of gratuitous transactions by a business corporation for the benefit of its shareholders. However, the purpose of the adoption of this provision was not to allow any other hidden distributions of profits and other proprietary resources of the corporation other than through the use of gratuitous transactions.

Thus, both gratuitous transactions provided by a business corporation for the benefit of its shareholders, as well as transactions for which the business the corporation receives inadequate consideration, thereby effectively reducing the corporation's assets (so-called non-equivalent performance) are still prohibited.

Hidden distribution of profits and other own resources from business corporations may result in the invalidity of the legal act through which such distributions are made. However, it is not possible to draw a blanket conclusion that any legal actions that might meet the definition of a hidden distribution of profits are invalid. Each individual case must be assessed using the proportionality test, considering the meaning and purpose of the legal rules prohibiting such conduct. However, in general it can be established that if a legal act leading to hidden distributions endangers the rights of the creditors of the business corporation, it is likely to be an absolutely void legal act. The reason for this conclusion is that legal rules protecting the position of creditors of a business corporation form part of public order.

**Keywords: hidden profit distribution, non-equivalent performance to shareholders, gratuitous performance to shareholders**