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Maintenance of Capital and Dividends

Dividends

There are rules in relation to profit distribution and the maintenance of capital. The purpose is to preserve the company‘s capital and assets intact for the benefit of creditors and other stakeholders. There are defined circumstances in which cash and other assets can be lawfully extracted from a company.

Dividends may only be paid out of distributable profits. Distributable profits are those ascertained in accordance with law and accepted accounting practice. See our separate chapter in relation to accounts. Accumulated profits from prior years may generally be paid out. However, if there is a deficit on the profit and loss account, dividends may not be paid until new profits have wiped out the deficit, and then only to the extent of the positive balance on the account.

Reduction of Capital

A company is not allowed to reduce its share capital other than in compliance with certain conditions. Private companies are permitted to reduce capital by special resolution. Three quarters of those voting must approve and it must be supported by a solvency statement.

It is also possible to reduce share capital by redemption or repurchase of shares. The reduction must be balanced by the issue of new shares or creation of a capital redemption reserve so there is no overall reduction of capital. The capital redemption reserve and share premium accounts are subject to the same rules in reduction of capital as issued share capital.

Private companies (only) may reduce capital without applying to Court for confirmation. They must adapt a special resolution detailing the reduction. A solvency statement must

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be filed in the Companies Office together with statement of the capital in which the directors take account of contingent and prospective liabilities. It must not result in members holding shares which are not redeemable shares.

Certain other types of capital reduction are permitted, subject to Court confirmation. Application to Court may be an alternative method to issuing a solvency statement.

Redeemable Shares

A company may issue redeemable shares. They may only be issued, provided there are also non-redeemable shares. On cancellation of shares, the company must reduce its issued share capital by the nominal value of the shares and subject to differing rules for public and private companies, must transfer the amount that is not made up from the proceeds of a new issue to a new capital account called a capital redemption reserve.

A public company's redemption of shares must generally come from company profits. When a share is redeemed, it must be cancelled. The amount of capital written off must be made up by a counter balancing increase either in share capital or premium on the issue of new shares or by transfer from the profit and loss account to the capital redemption reserve.

A private company may not pay for the redemption of its shares other than out of distributable profits or the proceeds of a new share issues. Certain procedures must be followed in redeeming shares. A private company may adapt a special resolution to enable it to redeem shares with less than a full counter balancing increase in the capital account. This is a resolution to make a payment out of capital. The extent of the counter balancing not done is limited to the permissible capital payment. This is computed in such a way that the company is forced to use all its available profits and use the proceeds of a new issue in making counter balancing transfers.

A special resolution to redeem shares with a payment out of capital must be adopted within five to seven weeks before payment is made. There are certain restrictions and

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rights for shareholders. The directors must make statements specifying the permissible capital payment together with a statement of solvency. A statement of solvency and report by the company's auditor is required. The auditor must confirm that he is not aware of anything which indicates that the statement of solvency is unreasonable. Certain information must be distributed to the shareholders.

The director's statement of solvency must state that there are no grounds whereby the company could be found unable to pay its debts after repayment of capital, that the company will continue as a going concern for the whole of the following year and will be able to pay its debts through that period.

If a company becomes insolvent within a year of making a payment out of capital, the members from whom the shares were purchased and the directors who made the statement are liable to repay the amount paid out of capital insofar as necessary to pay the company's debts.

The resolution, director's statement and auditors report must be filed with Companies House. The company must advertise in the London Gazette and must insert an advertisement in a national newspaper and notify all creditors by letter. The director's statements, auditors statements etc. must be made available free of charge to members and creditors. Within five weeks following the special resolution, the creditors or members who did not vote in favour of the resolution can apply to Court to cancel the resolution or alter its terms.

Company Purchase of Own Shares

A company may purchase its own shares under conditions set out in the Companies Act. Shareholders' approval is required. The position in respect of companies quoted on a stock exchange are more restrictive.

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The repurchase monies must come from distributable profits or be provided from the proceeds of a new share issue. A new share issue might be used to convert a class of shares or undesirable rights into more favourable shares.

The particulars of the purchase of shares must be filed with Companies House within 28 days. Copies of the relevant contracts must be kept available for inspection for 10 years.

A subsidiary is not entitled to be a member of its holding company and must not appoint a nominee to be membership of the company. This rule was introduced in 1948 to prevent a company evading the rule against purchase of its own shares. There are certain limited exceptions.

Financial Assistance for Purchase of own Shares

The Companies Act 2006 removes the prohibition on the giving of financial assistance for the purchase of its own shares by a private company. The prohibition still applies to a public company and all its subsidiaries (even if they are private companies).

The prohibition on giving financial assistance in the case of private companies was ultimately seen to be more trouble than it was worth. It was felt to be too difficult to balance the prohibition in such a way that did not prohibit entirely reasonable and beneficial arrangements.

The provisions in respect of public companies are broadly similar to those in Ireland, except that some of the exceptions are framed differently. The prohibition does not apply if the assistance is given in good faith, in the interests of the company and the principal purpose is not for the purpose of such acquisition or the giving of assistance is only incidental or part of a larger purpose. This exception was introduced in the 1980s in order to mitigate the effect of the general prohibition.

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This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.

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