

Ludgate Alert

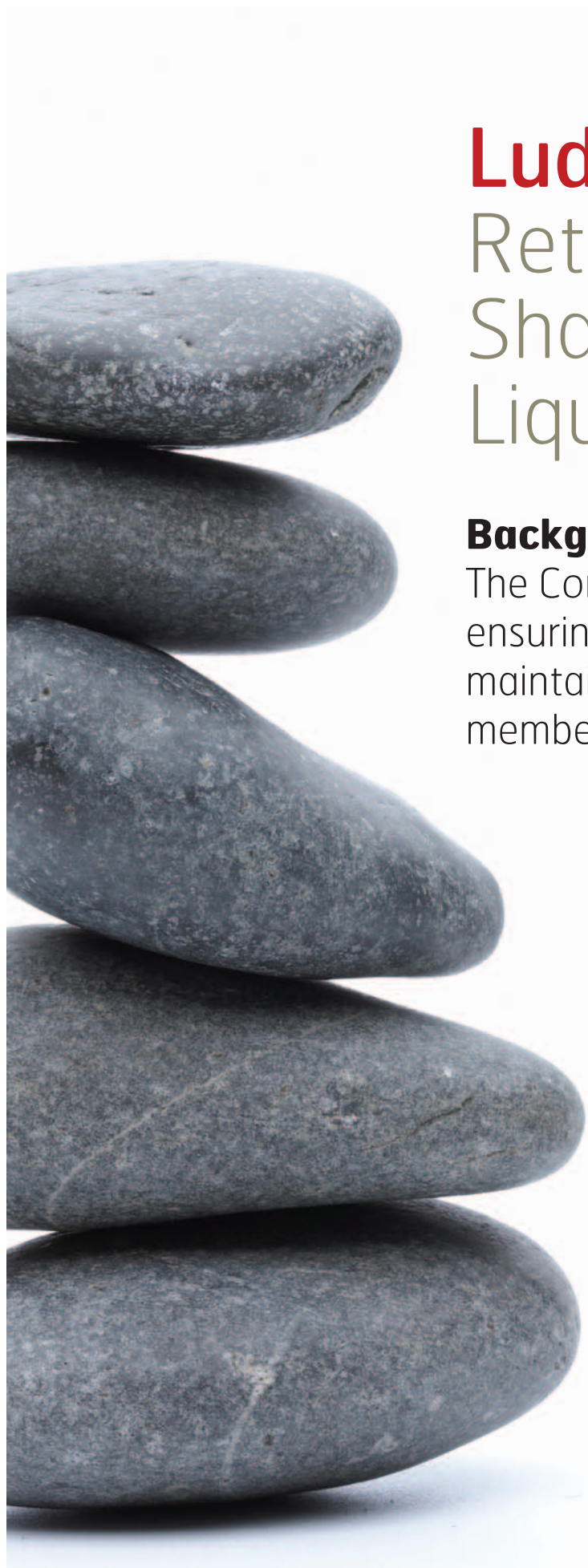
Return of Capital to Shareholders Outside Liquidation

Background

The Companies Act protects creditors by ensuring that a company's share capital is maintained and cannot be returned to its members while it remains a going concern.

The Act provides a number of exceptions which are generally well understood, but in one particular area is now causing concern. The Revenue has for many years allowed companies to take advantage of its Extra Statutory Concession C16, which allows a company to return share capital to members where it would be unreasonable to expect the company to be put into formal liquidation, because it would be uneconomic to do so.

The Treasury Solicitor issued guidelines in August 2006, a copy of which is attached for your information. In short it states that any capital distribution made outside of a winding-up process is unlawful, subject to certain exceptions which are strictly interpreted.



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Maintenance of Share Capital

One consequence of the rule that share capital has to be “maintained” is that dividends paid to the shareholders may only be paid out of the company's profits. Another consequence is that capital invested by the shareholders cannot be returned to them except:

- > with the approval of the Court.
The Companies Acts deals with the cases where with the approval of the Court capital can be returned to the shareholders.
- > when the company is put into liquidation, or
- > where the company redeems or purchases its own shares.

Unauthorised Distribution

If there is an unauthorised return of the share capital to the members, the company has a right to recover that money from its members. That right of recovery from the members is a “right” for the purposes of Section 654 of the Companies Act 1985, which would pass to the Crown as bona vacantia when the company is dissolved. If there was an unauthorised distribution of share capital to the members prior to dissolution, therefore, the Crown would be entitled to recover that distribution from the members. The only legal way to avoid this “right” passing to the Crown as bona vacantia is to put the company into formal liquidation prior to dissolution.

Permitted Distributions

It has been recognised that it would be unreasonable for the Treasury Solicitor to expect that a company is put into formal liquidation when that would be uneconomic, especially bearing in mind that HM Revenue and Customs Extra Statutory Concession C16 permits a distribution for tax purposes without the company having to incur the costs of a formal liquidation. It has therefore been agreed with HM Treasury that if:

- > a company has been struck off under either Section 652A of the Companies Act 1985, and
- > the shareholders have taken advantage of the extra statutory concession C16, and
- > the amount of the distribution is less than £4,000, then

as a concession the Treasury Solicitor will waive the Crown's right to any funds, which were distributed to the former members prior to dissolution.

The sting in the tail!

One worrying implication of the Treasury Solicitor's statement is that where a company has taken advantage of C16 and the company has subsequently been dissolved the right to recover the unlawful distribution rests with the Treasury Solicitor, who can claim ownership of the assets

Bona vacantia property belongs to the Crown and would be transferred to the Exchequer to be dealt with in the same way as money raised by taxation.

What can you do about it?

In essence the only way to sanitise these distributions is to restore the company to the Register, provided of course that legally this is possible. Once the company has been restored to the Register, the distribution properly authorised through a members voluntary liquidation process, the Crown would have no right to receive that money from its members. We have attached a copy of a letter recently received from the Treasury Solicitor's Office which clarifies this position.

We would be happy to discuss a sensible costing for any of your clients which need to be restored and liquidated and clearly if there are a significant number which need to be dealt with, our costs will reflect any economies of scale which that brings.