

Reorganization of company's share capital

Share capital reduction

Capital reduction is the process of reducing the share capital of a company. Section 407 of the Companies Act, 2015 highlights the main reasons for share capital reduction i.e.

- a. Cancelling any paid-up share capital that is lost or unrepresented by available assets.
- b. Repaying any paid-up share capital in excess of the company's requirements.

1. Public Companies

A Company registered as a public company can reduce its share capital by special resolution. Any public company interested in reducing its share capital must make an application to the High Court to confirm the decision before effecting the share capital reduction. The creditors of the Company are entitled to object to the reduction of the share capital.

The application for share capital reduction will only be processed by the Registrar of Companies after a Court Order has been obtained confirming the capital reduction.

2. Private Companies

Section 419 of the Companies Act, 2015, allows any registered private company an option to reduce the share capital without going through the court process.

Private companies intending to reduce their share capital are required to pass a resolution for reduction of capital which must be supported by a solvency statement.

The Directors of the company are required to execute a statement of solvency of the company in accordance with Section 421 (1) of the Companies Act, which must be within fourteen days after the resolution for reducing the share capital is passed.

The solvency statement is a statement that indicates that each of the Directors of the company:

- i) Has formed the opinion, as regards the company's situation at the date of the statement that no ground exists on which the company could then be found to be unable to pay (or otherwise discharge) its debts;
- ii) Has also formed the opinion if it is intended to commence the liquidation of the company within twelve months after that date – that the company will be able to pay (or otherwise discharge) its debts in full within twelve months of the commencement of the liquidation; or
- iii) In any other case, that the company will be able to pay (or otherwise discharge) its debts as they fall due during the year immediately following that date.

The option does not prevent private companies from petitioning the court for confirmation of the reduction of capital.

Sub-division of Capital

The sub-division of shares results in a larger number of shares with smaller nominal values. In other quarters, this is also referred to as a share split.

The shareholders of the company are required to pass an ordinary resolution approving the sub-division of shares in the company.

The rights attached to the particular shares in a company are not affected by subdivision of the shares. The process of share sub-division makes them cheaper and more affordable.

This option can be considered as the best for listed companies or companies intending to have their shares listed in the stock market.

Within one month after sub-dividing shares, a company is required to lodge with the Registrar of Companies for registration a notice specifying the shares that are affected, and accompanied by a statement of capital.

Consolidation of Shares

After the shares in a company have been consolidated, the end result would be a smaller number of shares with bigger nominal value.

This can be applied by listed companies when they want to reduce the number of shares trading on the market for strategic reasons.

The shareholders of the company are required to pass a resolution approving the consolidation of shares.

Within one month after consolidating shares, a company is required to lodge with the Registrar of Companies for registration a notice specifying the shares that are affected, and accompanied by a statement of capital.

Cancellation of Shares

This is the process by which a company cancels the issued or the unissued shares in a company.

Within one month after cancelling shares in order to comply with Section 427, a company shall lodge with the Registrar for registration a notice giving details of the cancelled shares.

Shares in a company can be cancelled under the following scenarios:

- Forfeited or surrendered shares in a public company if not re-allotted within three years are required to be cancelled.
- Share buyback (purchase of own shares)

It is worth noting that although share cancellation reduces share capital of the company, it cannot be considered or treated as a share capital reduction because of the circumstances under which the cancellation occurs.

Share Capital Concept under Companies Act, 2015

1. Statement of Capital and Initial Shareholding

The concept regarding the share capital at the incorporation stage is covered under Section 14 of the Companies Act, which states that all shares are required to be issued either as paid up or unpaid. The concept of unissued shares is not envisaged in the Companies Act, 2015.

The Companies Act, Chapter 486, allowed companies to have both authorised share capital and issued share capital hence allowing companies to have unissued shares.

Companies that were registered under the Companies Act, Chapter 486, have the option to allot unissued shares.

All companies registered under the Companies Act, Chapter 486, can explore the option of allotting unissued shares.

2. Share Capital Increase

The Companies Act, 2015 allows companies to increase share capital, and the stamp duty applicable is 1% on the value of increase. If stamp duty is not paid within the stipulated time, it attracts a 5% penalty on the stamp duty amount assessed on a quarterly basis.

The increase in share capital can be necessitated by factors that are both internal and external.

It is worth noting that after increasing the share capital of the company, all issued shares should be allotted either as paid up or unpaid.

3. Bonus Shares

Retained earnings of a company can be converted into shares and issued to shareholders as bonus shares.

Section 7 of the Income Tax Act, as amended by the Finance Act, 2018 states that “an amount shall be deemed to be a dividend distributed by a company to a shareholder where the amount is used by that company in any other manner for the benefit of the shareholder or any person related to that shareholder”.

KRA's interpretation of this section is that the conversion of retained earnings into ordinary shares will be deemed as a dividend and will therefore be subject to withholding tax, which results in a decrease in shareholders' funds.

Conclusion

Reorganization of a company's share capital often results in change to the structure of ownership and, depending on the needs of the company, reorganization of share capital through share capital reduction can lead to elimination of past losses hence enabling reserves to be distributed in future. A share buyback, on the other hand, can improve the earnings per share of a company while utilising excess cash.

Caveat

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