

PART 6

DISTRIBUTION OF PROFITS AND ASSETS

1. Part 6 deals with the distribution of profits and assets to members. The specific provisions on distributions are currently contained in sections 79A to 79P of Part IIA of the CO. Under the existing regime, “distribution” means every description of distribution of a company’s asset to its members whether in cash or otherwise, with a number of exceptions (e.g. a reduction of share capital and distribution in a winding up). The usual form of distribution is “dividend”.
2. If dividends can be paid despite the fact that the value of the net assets of the company is, or would become as a result of the payment, less than the value of the capital yardstick (i.e. the issued share capital plus share premium account and capital redemption reserve), then the purpose of the capital maintenance rules would be defeated. Part IIA lays down, for the protection of creditors, certain basic principles relating to the payment of dividends and the making of other distributions. The most important one is that a company may make a distribution only out of profits available for that purpose (section 79B(1)). A company’s profits available for distribution are its accumulated, realised profits (so far as not previously distributed or capitalised) less its accumulated, realised losses (so far as not previously written off in a reduction or reorganisation of capital) (section 79B((2)). Thus realised losses may not be offset against unrealised profits. Section 79C imposes a further restriction for listed companies.
3. Whether or not a distribution may be made within the terms of the CO is determined by reference to a company’s “relevant accounts”. Where it is proposed to make a distribution during the company’s first accounting reference period or before any accounts have been circulated, initial accounts must be prepared (section 79I). In all other cases, the relevant accounts are its last annual accounts that were circulated to members (section 79G) or interim accounts (section 79H), if the proposed distribution cannot be justified by reference to the last annual accounts.

4. The current rules on distribution have worked well and provide certainty. The CB does not propose any fundamental changes to the distribution provisions. This follows the consultation conclusions of the third topical consultation of not adopting a general solvency test in place of the capital maintenance doctrine¹.
5. Although the capital maintenance doctrine is largely retained, there are new exceptions based on a solvency test for reduction of capital, buy-backs and financial assistance. This wider use of the solvency test impacts on the current rules on distributions to a certain extent. For example, the exclusion of buy-backs out of capital from the definition of "distribution" (currently in CO s 79A(1)) would be wider under the CB (**Clause 6.1**) because of the wider circumstances where buy-backs can be made out of capital pursuant to the solvency test. Consequently, there could be more situations where "distributions" to shareholders under a buy-back are governed solely by the solvency test in Part 5 rather than the rules on distributions in Part 6.
6. There will also be technical amendments to change the terms used in Part 6 in accordance with the changes made in other Parts of the CB, e.g. the terms "profit and loss account" and "balance sheet" will be replaced by "financial statement" as in Part 9; the expression "purchase of a company's own shares" will be replaced by the term "buy-back" as in Part 5. References to "capital redemption reserve" and "share premium account" will be removed in parallel with the introduction of the no-par regime in Part 4. The existing section 79O of the CO would be removed as it is considered that there should not be exceptions for special classes of company (banking, insurance and shipping companies). The provisions will also be reorganised in a more logical and user-friendly way. Transitional provisions in this Part will be included in the finalised Bill.

¹ FSTB, *Consultation Conclusions on Share Capital, the Capital Maintenance Regime, Statutory Amalgamation Procedure* (February 2009), paragraphs 30 to 33.