THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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Your ref:

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Dear Adam

THE COMPANIES (REDUCTION OF SHARE CAPITAL) ORDER AND THE COMPANIES ACT 2006 (COMMENCEMENT NO. 7 AND TRANSITIONAL PROVISIONS) ORDER

The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the draft Companies (Reduction of Share Capital) Order and the associated draft Companies Act 2006 (Commencement No. 7 And Transitional Provisions) Order published by the Department for Business, Enterprise & Regulatory Reform (BERR) in May 2008.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

GENERAL COMMENTS

We continue to call for fundamental reform of the distributions regime. However, in the meantime, we support the more limited measure set out in the draft Companies (Reduction of Share Capital) Order 2008. We see this measure as the logical application of the current regime; that is to say, if an amount has, via a statutory creditor protection process, been removed from a company's capital, the logical complement to this is that the amount is, subject to the normal rules governing the drawing upon reserves available for distribution (eg the rules on accumulation, on relevant accounts etc), available for distribution. We therefore agree that any reserve arising from a capital reduction shall fall to be treated as a realised profit for the

purposes of Part 23 of the Companies Act 2006 (subject to contrary provisions in a court order, a resolution for the reduction of capital or the company's articles); it thus becomes distributable subject only to the Part 23 rules such as accumulation with other realised profits and losses etc. In particular, we agree that this provision should apply to the new capital reduction mechanism for private companies requiring solvency statements, in addition to the existing capital reduction mechanisms for private companies, as we believe all these mechanisms are all subject to appropriate legislative safeguards.

We note that the current draft of the associated Commencement Order provides that this measure will be applicable to reductions effected on or after 1 October 2008. However, as explained in more detail below, we see no reason why this measure should not be applicable (from 1 October 2008) to surpluses that have arisen on capital reductions effected prior to that date, and we believe there should also be an explicit transitional provision for unlimited companies. We also suggest below a possible alternative transitional adaptation for the filing regime that will apply during the 12 month transitional period.

SPECIFIC COMMENTS

1. We note that regulation 3(2) of the Draft 7th Commencement Order contains the following transitional adaptation of s644:

> '(1A) Where a company reduces its share capital under subsection (1)(a), the special
> resolution under this section must make any necessary alterations of the company's
> memorandum by reducing the amount of its share capital and of its shares.'

We note this transitional adaptation will only govern filings during a twelve month period (after which the new 2006 Act provisions will apply). We wonder whether, as an alternative to the proposed adaptation set out above, it would be simpler for the wording of the transitional filing requirements to replicate those under the existing s138 provisions. One advantage of this approach would be that this temporary provision would be stated in terms that are similar to those of the 85 Act provision – there seems little point in having new wording that would only be operable for a twelve month period.

Such an alternative approach could be achieved by amending the Draft 7th Commencement Order as follows:

> "(1A) ~~Where a company reduces its share capital under subsection (1)(a), the special resolution under this section must make any necessary alterations of the company's memorandum by reducing the amount of its share capital and of its shares.~~ The memorandum complying with subsection (2) when registered is deemed to be substituted for the corresponding part of the company's memorandum, and is valid and alterable as if it had been originally contained therein.

(1B) The substitution of such a memorandum complying with subsection (2) for part of the company's memorandum is deemed an alteration of the memorandum for purposes of section 20 of the Companies Act 1985."

We also note that it is the filing (and not the resolution) that amends the company's memorandum. Paragraph 1A proposed by BERR could be interpreted as requiring that the resolution itself alters the memorandum, which may cause confusion. This would be avoided under the alternative approach we suggest above.

2. The 7th Commencement Order (paragraph 7(2)(a)) provides that section 654 shall apply to reductions that take effect under the 85 Act on or after 1 October 2008 (irrespective of when the special resolution is passed).

However, capital reductions by unlimited companies are not governed by the capital reduction provisions in CA85 or CA06, but are instead conducted pursuant to the company's articles of association. Unlimited companies are therefore not covered explicitly by the transitional provision at paragraph 7(2)(a). We believe there should be a transitional provision to provide clarity that the s654 regulations apply to surpluses arising from capital reductions of unlimited companies.

We also consider that section 654 (and the Regulations made pursuant thereto) should be applicable prospectively (ie as from 1 October 2008) to all surpluses that have arisen on capital reductions, irrespective of when the reduction took effect. We see no reason why such surpluses should be treated any differently from those arising in respect of reductions effected on or after 1 October 2008. As we noted earlier, what is no longer capital should logically become the basic stuff of distributable reserves, and the measure under section 654 provides a long overdue statutory rule to that effect. Logically the new rule should thus also apply going forward to all reserves on hand at 1 October 2008. Furthermore, given that solvency statement capital reductions can only take place from 1 October 2008, and that current treatment of surpluses arising under a court sanctioned reduction is effectively preserved under the s654 regulations (because such surpluses are already considered realised except to the extent that the company has undertaken that it will not treat the reserve arising as a realised profit, or where the court has directed that it shall not be treated as a realised profit), making the s654 regulations applicable to all surpluses as from 1 October 2008 would effectively only apply to unlimited companies. Arguably, unlimited companies should not be within the capital maintenance regime in any event as they have unlimited liability and thus their creditors are not in need of the capital maintenance protections. We acknowledge that there may be relatively few surpluses carried forward as at 1 October 2008 arising from capital reductions of unlimited companies, but such a transitional provision would provide certainty that any such surpluses are realised, without needing to assess whether the capital was originally injected in the form of qualifying consideration. This approach would also obviate the need for a provision to live on in ICAEW technical releases for unlimited company reductions before 1 October 2008.

Therefore, we believe that transitional provision 7(2) should be amended to read as follows:

'7. (2) Section 654 of the Companies Act 2006 (treatment of reserve arising from reduction of capital) applies and the Companies (Reduction of Share Capital) Order 2008 apply—

(a) in relation to a reserve that arises or has arisen from a reduction of capital taking effect under Chapter 4 of Part 5 of the Companies Act 1985 or Chapter 4 of Part 6 of the Companies (Northern Ireland)

Order 1986 ~~on or after 1st October 2008~~, irrespective of when ~~the special resolution for~~ the reduction took effect; ~~was passed; and~~
(b) in relation to a reserve arising from a reduction of capital by an unlimited company, irrespective of when the reduction took effect; and
(c) in relation to a reduction of capital under the provisions of the Companies Act 2006 mentioned in article 2(a) above.'

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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