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Guide to Reduction of Capital under Hong Kong New Companies Ordinance

1. Introduction

The new Hong Kong Companies Ordinance (the 'New Ordinance') was passed by the Legislative Council on 12 July 2012 and is set to take effect from 3 March 2014. The last major review and amendment of the existing Companies Ordinance (Cap 32) (the 'Existing Ordinance') was undertaken in 1984. The majority of the provisions of the Existing Ordinance originated from the UK Companies Act 1929 and the statute was generally felt in need of overhaul.

Upon its implementation, the New Ordinance replace the Existing Ordinance to become the legal framework for the formation and operation of companies in Hong Kong (including overseas companies operating in the jurisdiction). The changes to be introduced by the New Ordinance are extensive and will affect not just companies themselves but also parties who have dealings with companies, such as members and creditors.

This article aims to explain in brief changes in respect of the process for reduction of capital introduced in the new Companies Ordinance.

2. Summary of changes

In accordance with Existing Ordinance, a company must go through a court-sanctioned process in order to reduce its share capital.

The New Ordinance introduces a new court-free process for capital reduction. The court-free process requires directors to give a solvency statement in order to reduce the company's capital. The court-free process simplifies the procedures for reducing share capital. It will be a faster and cheaper alternative to the court-sanctioned process.

At the same time, the New Ordinance also retains the existing court-sanctioned process for reduction of share capital, so there are two separate ways to reduce capital.

3. Use of the New Court-Free Capital Reduction Process

If a company wishes to reduce its capital through the court-free process, it needs to meet all of the requirements listed below:

- (1) the proposed capital reduction must be approved by the directors of the company;
- (2) each director must sign a solvency statement;
- (3) within 15 days of the date of the solvency statement, the shareholders of the company must pass a special resolution approving the reduction of share capital;
- (4) certain public notices must be published in the Government Gazette, in one specified Chinese newspaper and in one specified English newspaper; and certain forms (including the solvency statements in specified Form NSC17) must be filed with the Companies Registry.

Any creditor or non-approving shareholder of the relevant company may, within 5 weeks of the date of the special resolution, apply to the court for cancellation of the resolution. Upon such application, the court must either make an order confirming or cancelling the special resolution for the reduction of share capital.

If no application is made to a court by a creditor or a non-approving shareholder, a return setting out the share capital of the relevant company must be filed with the Companies Registry no earlier than 5 weeks and no later than 7 weeks after the date of the special resolution. The reduction of share capital takes effect from the date on which such return is registered by the Companies Registry.

4. The Solvency Statement

The solvency statement is a uniform solvency statement that applies not only to the court-free process for reduction of share capital but also to share buy-backs out of capital. The solvency statement must be in the form prescribed by the Companies Registry (Form NSC17).

It is required that the solvency statement must be made by all directors of the company and each director must form the opinion that:

- (1) immediately after the transaction there will be no ground on which the company could be found to be unable to pay its debts;
- (2) either (a) if it is intended to commence the winding up of the company within 12 months after the date of the reduction of share capital, the company will be able to pay its debts in full within 12 months after the commencement of the winding up; or (b) in any other case, the company will be able to pay its debts as they become due during the period of 12 months immediately following the date of the reduction of share capital.

In forming their opinion, the directors must:

- (1) inquire into the company's state of affairs and prospects;
- (2) take into account all the liabilities of the company (including contingent and prospective liabilities).

It is a criminal offence for a director to make a solvency statement without having reasonable grounds for such opinion. Such director may be liable for a fine of up to HK\$150,000 and imprisonment of up to 2 years.

5. Implications for Practice

Directors should carefully enquire as to the state of affairs of the company before signing a solvency statement. This may include instructing professional accountants and financial advisers to assess the current financial status of the company and the projected financial health of the company after the capital reduction.

The basis for forming the opinion in a solvency statement should be recorded by the directors in writing. The directors' resolution approving the capital reduction should also set out clearly the factors that the directors have taken into account and the reasons for forming their opinion in the solvency statement.

6. Reserves Arising from a Reduction of Share Capital

Section 214 of the New Ordinance clarifies that reserves arising from a reduction of share capital may be regarded as realized profits and may be distributed to shareholders as dividends.

If you wish to obtain more information or assistance, please visit the official website of Kaizen CPA Limited at www.kaizencpa.com or contact us through the following and talk to our professionals:

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