

## **The Court-Free Process for Reduction of Capital in Hong Kong**

The Companies Ordinance (Cap. 622) (“CO”) has introduced a court-free process for reduction of capital of companies. The court-free process requires directors to give a solvency statement in order to reduce the company’s capital. It will be a faster and cheaper alternative to the court-sanctioned process where the company is clearly solvent. The governing provisions for the court-free process for reduction are contained in sections 215-225 of the CO.

### **Reasons for Reduction of Capital**

There may be changes in the company’s business which result in the company having more issued capital than is required for its operation. It may be appropriate for excess capital to be returned to members.

The company may also wish to cancel paid-up capital where the company has significant losses in its business of a permanent nature. The reduction of capital in the company’s accounts can reflect the true financial position of the company. The losses can be written off by the reduction and there is a bringing forward of the time when the company may be in a position to pay dividends to its members.

### **Types of Reduction**

The types of reduction include a company: (i) reducing the liability on any shares in respect of share capital not paid up; (ii) cancelling any paid up share capital that is unrepresented by available assets; or (iii) repaying any paid up share capital which is in excess of the wants of the company.

Reduction is subject to any provisions in the company’s articles that prohibit or restrict a reduction. If the company’s articles contain such a prohibition or restriction, it is necessary for the company to alter its articles before the reduction. Please also note that if the reduction would result in its members holding only redeemable shares, the company cannot reduce its capital.

### **Procedure requirements for Reduction**

The procedure requirements for reduction of capital are as follows:

- The directors make a solvency statement which must be sent to the members at or before the time when the proposed resolution is sent to them.
- The special resolution must be passed within 15 days after the date of the solvency statement.

- Company publishes a notice of the company's approval of the reduction in the Gazette on or before a date that falls on the last working day of the week after the week in which the special resolution is passed, or if that period is less than 4 business days (excluding the day of the resolution and that last working day), a date that falls on the last working day of the week next following.
- Company publishes a notice of the company's approval of the reduction in one Chinese newspaper and one English newspaper before the end of the week after the week in which the special resolution is passed or alternatively, gives written notice to the same effect to each of the creditors.
- Company delivers Form NSC17 (Solvency Statement) to the Registrar of the Companies no later than it publishes the notice in the Gazette or, if earlier, when it first publishes the notice in the newspapers.
- Special resolution and the solvency statement are kept at the company's registered office from the date the company publishes the notice in the Gazette or, if earlier, when the company first publishes the notice in the newspapers until 5 weeks after the date of the resolution. A member or creditor may inspect them without charge in that period. Please note that a member or creditor may apply to the Court within 5 weeks after the special resolution for it to be cancelled.
- If there is no application to the Court, Form NSC19 (Return of Reduction of Share) must be registered with the Registrar of the Companies no earlier than 5 weeks and no later than 7 weeks after the date of the special resolution.
- The reduction of capital takes effect when the return is registered by the Registrar of the Companies.

### **Solvency Statement required for Reduction**

The solvency statement is required to be made by directors. Under the solvency statement, the directors must be satisfied that:

- immediately after the reduction of capital there will be no ground on which the company could be found to be unable to pay its debts; and
- either:
  - (a) if it is intended to commence the winding up of the company within 12 months after the date of the reduction of 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 capital.

In forming an opinion, a director must inquire into the company's state of affairs and prospects; and take into account all the liabilities of the company (including contingent and prospective liabilities).

A director who makes a solvency statement without having reasonable grounds for the opinion expressed in it commits an offence and is liable to a fine of HK\$150,000 and to imprisonment for 2 years. There is also a possibility of the directors being in breach of their duties owed to the company.

**Practical Implications**

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

If you have any queries regarding this article or any other questions relating to reduction of capital of the company, experienced solicitors in our Corporate & Commercial Department will be happy to assist you.

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