



RETURNING VALUE TO SHAREHOLDERS OF HONG KONG COMPANIES – *DIVIDEND DISTRIBUTION, CAPITAL REDUCTION AND SHARE BUY-BACK*



A company may wish to consider ways in which it can provide returns to shareholders. If initially a shareholder has provided funding to the company in the form of a shareholder's loan, then the shareholder may receive repayment of the loan (and in some cases, with interests) in accordance with the term of the relevant loan agreement. However, what if the shareholder originally put money into the company via capital injection? Or what if the company has generated significant revenue far exceeding the shareholder's loan amount (if any)? How can a shareholder obtain any return from the company without liquidating the company? We highlight below three possible options available in Hong Kong which are quite common: (i) distribution of dividends; (ii) capital reduction and (iii) share buy-back.

Distribution of dividends

This is a very common and straightforward way for a company to share profits with its shareholders. Subject to its articles of association, generally a Hong Kong company may declare final dividends by ordinary resolutions provided that such dividends shall not exceed the amount recommended by the directors, and board resolutions would be sufficient for approving interim dividends in cash.

Nonetheless, to declare any dividends (whether interim or final), the Hong Kong company must have sufficient profits available for distribution. Moreover, usually distribution of dividends should apply to all (but not to only some) of the shareholders in the same class, and the amount of dividends to be received by shareholders of the same class would be pro-rata to their shareholding.



Capital reduction

A reduction of share capital of a Hong Kong company may take many forms, one of which is repaying any paid-up share capital in excess of the company's needs for its optimal operation and growth.

Under the Companies Ordinance (Cap. 622 of the Laws of Hong Kong) ("**Companies Ordinance**"), Hong Kong companies may take advantage of the court-free procedures for reducing capital to return excess capital to shareholders. To implement a court-free capital reduction, the company needs to undergo certain procedures in accordance with the Companies Ordinance, which usually take around 6 to 8 weeks. In addition, whilst it is not necessary for the company to have sufficient distributable profits, the company must satisfy the prescribed solvency test, and the directors of the company are required to make a solvency statement to confirm that (i) there will be no grounds on which the company could be found to be unable to pay its debts immediately after the capital reduction and (ii) (assuming that the company is not intended to commence winding up within 12 months after the reduction) 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 capital reduction.

It is very important for the directors making the solvency statement to have reasonable grounds for the opinion expressed therein, otherwise s/he will commit an offence and may be subject to fines and imprisonment. In forming an opinion for making the solvency statement, the directors must inquire into the company's state of affairs and prospects (e.g. by obtaining and reviewing updated financial statements of the company) and take into account all the liabilities of the company (including contingent and prospective liabilities).

Share buy-back

Provided that its articles of association do not prohibit nor restrict a buy-back, a Hong Kong company may purchase its own shares in accordance with the provisions under the Companies Ordinance, and the relevant shareholders can receive the amount of the purchase price accordingly.

Compared with the other two options, share buy-backs are more flexible in terms of the source and amount of payment, as a Hong Kong company may make payment in respect of buy-back of its own shares (i) out of its distributable profits; (ii) out of the proceeds of a fresh issue of shares made for the purpose of a buy-back; or (iii) out of capital in accordance with the Companies Ordinance.

The Hong Kong company may buy back all or part of the fully paid shares of any shareholder at any price as they may mutually agree under a contract that is authorized in advance by special resolution, so long as there will be at least 1 member holding any share(s) other than redeemable shares after the buy-back and other conditions under the Companies Ordinance are complied with.

If the payment in respect of a share buy-back is made by the company out of its capital, the directors of the company will also need to make a solvency statement (like in the case of capital reduction), and there will be other additional requirements under the Companies Ordinance compared with the other payment methods.

Subject to the adjudication of the Stamp Office, stamp duty may be payable on the transfer documents for any share buy-back. Companies that are planning to implement share buy-backs should consider the tax implications.



Brief summary of the 3 options

	Dividend distribution	Court-free capital reduction	Share Buy-back
Court approval required?	No	No	No
Requirement for profits available for distribution	Yes	No	No, unless payment made out of distributable profit
Solvency statement requirement	No	Yes	Yes, if payment made out of capital

How we can help

At SF Lawyers, our team of experts in corporate and commercial laws has extensive experience in different ways for returning value to shareholders of Hong Kong companies (including but not limited to the three options mentioned above), and we have provided assistance to many clients in this regard. We may collaborate seamlessly with our network of professionals at KPMG to provide legal, tax and accounting advice on the options for paying back shareholders in view of the situation of a particular company, to analyze the pros and cons of each option for determining which one would be the best for the company, and to assist in the implementation.

If you require any assistance, please do not hesitate to approach us, and we will provide holistic, practical and tailor-made services to suit your needs.

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Important: This article is only intended to provide a general outline on the topic and should not be taken as formal legal advice. If you would like to know more or require assistance, please feel free to contact us.



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