

*These notes refer to the Companies Act 2006 (c.46)
which received Royal Assent on 8 November 2006*

COMPANIES ACT 2006

EXPLANATORY NOTES

COMMENTARY

Part 17: a Company's Share Capital

Chapter 11: Miscellaneous and Supplementary Provisions

Section 654: Treatment of reserve arising from reduction of capital

974. This is a new provision which enables the Secretary of State, by order, to specify the circumstances in which a reserve arising from a reduction of capital will be distributable.
975. Whilst there is no requirement in the Act (or indeed the 1985 Act) to create a statutory reserve following such a reduction, we understand that it is usual for companies to create an accounting reserve in these circumstances to “balance the books” (that is, the section relates to reserves that arise as a result of generally accepted accounting treatments). Currently, the question whether a reserve arising from a reduction of capital (which, for a limited company, may currently only be made pursuant to a court order) may be treated as a realised profit for the purposes of computing whether a company has sufficient distributable profits to make a distribution, is the subject of technical guidance issued by the Institutes of Chartered Accountants. The Act introduces a new procedure which enables private companies to reduce their share capital without going to court (see section 641) which is not on all fours with the court approved route (in particular there is no requirement to settle a list of creditors or to provide security for the company's debts) and in the circumstances it is desirable to deal with the question of when amounts credited to such a reserve should be treated as a realised profit in statute. Owing to the technical nature of the rules that will need to be made this issue will be dealt with in secondary legislation. An order made under section 654 will however be subject to the affirmative resolution procedure – that is, the regulations will need to be approved by both Houses of Parliament.