



# IFE BUSINESS LAW REVIEW

A JOURNAL OF THE DEPARTMENT OF BUSINESS LAW, OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE, OSUN STATE, NIGERIA.

## A COMPARATIVE EXAMINATION OF THE DOCTRINE OF CAPITAL MAINTENANCE UNDER THE UNITED KINGDOM AND NIGERIAN CORPORATE LAWS

Alfred Abhulimhen-Iyoha\* and Ijalana Emmanuel Folayan\*\*

### ABSTRACT

The paper examined the existing legal framework of corporate law and professional practices on capital maintenance in the United Kingdom and Nigeria. These were with a view to undertaking a holistic analysis of the circumstances under which companies' capital may be lawfully reduced without affecting the creditors' and shareholders' interests. The study relied on primary and secondary sources of information. The primary source included unstructured interviews with corporate consultants/authorities, judicial decisions, laws relating to company operation in Nigeria and the United Kingdom. The secondary source included books, journal articles, conference proceedings, newspaper publications and the internet. The study revealed that although adequate statutory provisions are made, for protection of the rights of the creditors and shareholders in corporate law, this object may not be realisable unless adequate monitoring mechanisms are put in place. It also revealed that notwithstanding the various statutory regulations aimed at preserving a company's capital, the directors' personal interests often resulted in companies' inability to perform their obligations, when required. It further revealed that the company's directors are liable for any misdealing with the company's capital.

**KEY WORDS:** Reserve, Assets, Capital, Capital Maintenance, Shares, Dividends

### 1.0 INTRODUCTION

The concept of capital maintenance of companies is a laudable measure aimed at keeping companies financially stable and secure. Limited liability companies are, most times, capital intensive.<sup>1</sup> Their running capitals are beyond the financing capacity of the authorized share capital or paid-up capital, and as such, funds are sourced from expanded channel, to run the business by way of debentures, credit purchase, hire-purchase etc. While shareholders are owners of the company and could protect their interest through votes at the company's meetings, and inclusion of special clauses in the memorandum and articles of association, suppliers and debenture holders are not owners but creditors whose interests somehow, also need protection, even from dubious directors and shareholders; hence, the need for the intervention of the law.

Apart from case law, the major laws, regulating companies' registrations and administration in the United Kingdom are the successive Company Laws while that of Nigeria, is the Companies and Allied Matters Act (hereinafter referred to as CAMA).<sup>2</sup> To protect shareholders and the company's creditors, the law ensures that issued capital, scripts, bonus issue, and share premium cannot be reduced or returned to the shareholders and it provides, for private and public

\* ALFRED ABHULIMHEN-IYOKHA, (Ph.D.), is a Chief Magistrate Grade 1, with the Edo State Judiciary, High Court Complex, Sapele Road, [aaiyoha@yahoo.com](mailto:aaiyoha@yahoo.com).

\*\* IJALANA, EMMANUEL FOLAYAN, (Ph.D.), is a law lecturer at the Dept. of Jurisprudence and Private Law, Obafemi Awolowo University, Ile-Ife, Osun State, [ijalanaef@gmail.com](mailto:ijalanaef@gmail.com).

<sup>1</sup> Paul L. Davies: *Principles of Modern Company Law*, South Asian Edn., (London: Sweet & Maxwell, 2008), P. 305.

<sup>2</sup> The Companies and Allied Matters Act, Cap C 20, Laws of the Federation of Nigeria, 2004.

companies, the minimum capital requirements. For this purpose, a company is not allowed to issue its shares at a discount<sup>3</sup> or pay dividends out of capital.<sup>4</sup> It may only, with the sanction of the court, reduce capital.<sup>5</sup>

The word "share" is defined by section 650(1) of CAMA,<sup>6</sup> as meaning:

... the interests in a company's share capital of a member who is entitled to share in the capital or income of such company; and except where a distinction between stock and shares is expressed or implied, includes *stock*.

The burden of this paper therefore is to Comparatively, discuss, in the light of the Nigerian and United Kingdom's corporate laws, the various ways by which the finances, capital or assets of the companies, can lawfully be consolidated, protected conserved or preserved, thereby protecting the creditors and preserving companies from collapse.

## 2.0 CAPITAL MAINTENANCE CONCEPT

In the Company Law Review's *Strategic Framework Document*, capital maintenance is described as,

*A narrow ... and... technical issue concerning the preservation of certain reserves which are currently designated as not normally distributable to members.*<sup>7</sup>

Capital maintenance is a concept which ensures that a profit can only be realised after the firm's capital on two conditions. These are, either when there is a full restoration of the company capital to its original level (which is otherwise christened capital recovery) or the maintenance of company capital to its benchmark. This becomes imperative as a necessary an anti-dose for determination of the value of the company capital before computing the amount, appropriate as profit. Put differently, it is a concept that insists on the company's income being ascertained only after the full recovery of all costs incurred in the course of its operations or after the due maintenance of its capital.<sup>8</sup> This indicates that a company can only be said to make a gain after recovering fully, the costs expended on its operations during the period under accounting review.

In a review,<sup>9</sup> Will Kenton posited a similar position when he identified it as:

*... an accounting concept based on the principle that a company's income should only be recognized after it has fully recovered its costs or its capital has been maintained. A company achieves capital maintenance when the amount of its capital at the end of a period is unchanged from that at the beginning of the period. Any excess amount above this represents the company's profit.*<sup>10</sup>

The concept of capital maintenance is predicated upon the doctrine which propounded that since a company's issued share capital is guaranteed fund or a permanent fund reserved for settlement of claim of the company's creditors of a company, the issued company's share capital should neither be reduced, nor be returned to shareholders except as permitted by Law (the Companies

<sup>3</sup> *Ibid*, section 159.

<sup>4</sup> See subsection 5 of 318, *ibid*.

<sup>5</sup> *Ibid* at section 106.

<sup>6</sup> The CAMA, *op.cit*.

<sup>7</sup> John Armour, *Capital Maintenance*, available at <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.175.7065&rep=rep1&type=pdf>, accessed on 21 September, 2019.

<sup>8</sup> Will Kenton, "Capital Maintenance" hosted at <https://www.investopedia.com/terms/c/capital-maintenance.asp>, accessed on 7/11/2019.

<sup>9</sup> *Ibid*.

<sup>10</sup> *Ibid*.

Act or the common law).<sup>11</sup>

The doctrine, through a horde of judicial interpretation, developed in England. The starting point was in the *Flitcrofts case*,<sup>12</sup> where Jessel M.R indirectly emphasized the creditors' right to ensuring that the company's capital is not unlawfully dissipated; and the members' duty of restoration of company's capital surreptitiously returned to them. This forms the basis for capital maintenance and governed both capital reduction and company distribution.

The *locus classicus* for capital maintenance concept was the case of *Trevor v. Whitworth*,<sup>13</sup> where almost a quarter of its own shares, was repurchased by a company. In a subsequent proceeding for the company's liquidation, a shareholder sought the outstanding debts, the company owed to him on the repurchase. Against the Court of Appeal's approval, the House of Lords in a further appeal declaring the buyback *ultra vires* the company in line with public policy, held that even with a provision contained in the company's memorandum of association allowing the purchase, it cannot validly purchase its own shares on the ground that allowing that would amount to a reduction of company's capital. The court further held that it was only when capital reduction of the company received duly, the sanction of the court that a return of company capital to members would be allowed.

The above holding was intended to protect creditors of the company against losses that could result from the diminution of the company's capital. The rationale for creditor's protection was further explained by the decision of Lord Watson who had held that:

*Paid-up capital may be diminished or lost in the company trading, that's a result which no legislation can prevent; but persons who deal with and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out except in the legitimate course of its business.*<sup>14</sup>

It may interest us to note that apart from protecting the creditor, the punitive remedy has always been intended against reckless directors right from the *Flitcrofts' case*.<sup>15</sup> This was with a view to making them accountable for the mischief occasioned by their actions. This object, no doubt, was too apparent in the judgment. Lord Jessel MR, held further that:

*It follows then that if directors who are quasi trustee for the company, improperly pay away the assets to shareholders, they are liable to replace them. It is no answer to say that the shareholders could not compel them to do so. I am of the opinion that the company could in its corporate capacity compel them to do so, even if there were no winding up.... directors, in each case, are to be declared, jointly or severally, liable.*<sup>16</sup>

<sup>11</sup> The CAMA, *op.cit.*

<sup>12</sup> In re: Exchange Banking Co. (*Flitcrofts' case*) (1882) 21 Ch. D, 519.

<sup>13</sup> (1887) 12 App Cas 409. The universal doctrine became deeply rooted in the common law and many corporate statutes such as the English.

<sup>14</sup> *Ibid* at pp. 423-424.

<sup>15</sup> In re: Exchange Banking Co. (*Flitcrofts' case*), (*Supra*)..

<sup>16</sup> *Ibid.*

In a later case, *Ooregum Gold Mining Company of India Ltd v. Roper*,<sup>17</sup> it was similarly, the opinion of Lord Halsbury that the company's capital was fixed and certain, therefore it was a security that every company's creditor of the company was entitled to hold onto as a guarantee. This judicial protection was again re-affirmed, in *Aveling Barford Ltd. v. Perion Ltd.*,<sup>18</sup> when the court affirmed that *until every creditor is paid, shareholders cannot withdraw their, on a winding up of company as a guarantee.*

For the avoidance of doubts, the capital of the company capital, to which the creditors looked unto as a guarantee for protection, it must be noted, consists issued share capital, the share redemption reserve and the capital redemption reserve.<sup>19</sup> For the effectual purposes of doctrinal and conceptual understanding of capital maintenance with its possibilities and potentials for companies' stability in Nigeria, it is necessary to undertake a holistic comparative excursion into capital maintenance's functionality in other clime, like the United State, where it has recorded substantially, unprecedented reformation and development.

### 3.0 CORPORATE LAWS REGULATING THE DOCTRINE OF CAPITAL MAINTENANCE IN UNITED KINGDOM

In 1980, in the United Kingdom, there was a reform of the rule relating to the doctrine of capital maintenance thereat replacing it with a statutory procedure which ensured the classification of shares into either as redeemable or be bought back, under the Company Act 2006 (CA 2006).<sup>20</sup> The (CA 2006), in England, makes substantial changes to the rules governing capital maintenance thereby relaxing a number of the statutory requirements in this regard, in accordance with the deregulatory objectives of the Act. In order to ex-ray some grey areas of law, already developed on capital maintenance, and explain the recent deregulatory measures thereat introduced, the nature and effects of this relaxation will be discussed hereunder.

Admittedly, the principles which generally governed the capital maintenance doctrine were developed, originally by the courts and had since increasingly been modified by statutory enactments more particularly, the provisions of Part V of the Company Act 1985 (CA 1985) and that of Parts 17, 18 and 23 of the C A 2006 (from the applicable dates of implementation). Consequently, in particular, the rules relating to unlawful financial assistance, no longer apply to private companies, from 1 October 2008, and in most circumstances without the need to go to court, an allowance was conceded for reduction of their share capital.

Specific areas of legal intervention in this regards, are,

#### a. Distributions

In Part 23 of CA 2006 which applies to distributions made on or after 6 April 2008 i.e its commencement's date, the provisions, relating to distributions, have been restated broadly to preserve existing rule disallowing payment of dividend or making distribution to members, only out of profits available for the purpose by reference to "relevant accounts" as contained in Part

<sup>17</sup> [1892] A C. 125 at 133.

<sup>18</sup> (1989) BCLC 626 at p. 630-3.

<sup>19</sup> See section 105(1) & (2) of the Companies and Allied Matters Act, *op.cit* which provide that except as authorized by the Act, a company having a share capital shall not reduce its issued share capital and that for the for the purposes of reduction of share capital, any issued of share capital shall include the share Premium Account and any Capital Redemption Reserve Account of a company.

<sup>20</sup> See sections 684 – 723 of UK Companies Act, 2006..

23 relating to rules governing when and how such permissible distributions are payable.

#### **b. Reduction of Share Capital**

Commencing from October 1<sup>st</sup>, 2008, a new procedure was introduced by the CA 2006, allowing the reduction of share capital of private companies, upon a special resolution supported by a solvency statement from all the directors, for the reduction is. An approval of court is not required in this procedure. Akin to this introduction, is the extension to private company, of the capacity to have its capital reduced, in any manner. This capacity was limited to only unlimited company, before the reform.

The duty of due diligence becomes essentially while giving a statement of solvency. Directors are not allowed to employ the use of protective qualification against utter recklessness in a solvency statement in any manner, as this will attract criminal sanctions. This is because, such recklessness may, by its very nature, impute fraudulent misrepresentation which also, is a criminal offence. The nature and extent of the directors' liability, is predicated depend on the facts of each case. With some minor modification which came into effect on 1 October 2009 as regards the court's confirmation of capital's reduction, the CA 2006 broadly restates the procedure contained in the CA 1985. Both public and private companies are at liberty to exploit the court-approved route. This is, however, different from what operates in the above new procedure, in the case of private companies permitting, without courts' sanction, a reduction of private company's capital upon a resolution backed with the solvency statement from the directors.

#### **c. Prohibition of Financial Assistance**

Effective from October 1, 2008, there was a repeal of the provisions forbidding, in most circumstances, financial assistance by private companies. Consequently, from the date of the repeal, the statutory whitewash procedure ceased to exist. This is without prejudice to continuation of the prohibition contained in the CA 1985 relating to public companies giving financial assistance, until its replacement, on October 1, 2009, with a similar provision in Chapter 2 of Part 18 CA 2006 though, its restraint for a private companies, the acquisition of shares, either directly or indirectly, in its public holding company.

Arising from the above repeal in the light of the company's best interest as contained in Section 172 of the CA 2006 and without breaching the rules on company's capital,<sup>21</sup> is the urgent need for a holistic consideration of the legal principles which still regulate transactional operation against the backdrop of corporate law and practice, on areas previously treated as unlawful financial assistance, despite the repeal.

#### **d. Purchase of Own Shares**

A limited company, as general rule, is restrained from acquiring its own shares by means of purchase, subscription or otherwise except on condition allowed by law. Part 18 CA 2006, which came into effect on October 1, 2009, summed up the current methods under which a limited company may its own shares. To this end, section 658<sup>22</sup> restrains a limited company from acquiring its own shares in any manner other than as permitted under the said Part 18 CA 2006. A major vantage of reduction of share capital by a company which purchases its own shares is that the price purchase price for the concerned shares may surpass the value of capital

<sup>21</sup> Emmanuel Umbu, "Capital maintenance: Why should companies seek to maintains its capital other that for commercial performance", available at [www.principality.com](http://www.principality.com). Accessed 10 October 2019

<sup>22</sup> The Unite Kingdom's CA 2006

represented by those shares. CA 2006's main amendment was in the repeal of the legal restraint on the private company from giving financial assistance and introduction of the new process of reduction of private company's capital without the leave of court. These are laudable innovation. This is because, by these changes, a good number of transactions become simplified and it is also time and cost effective.

#### **4.0 ESSENTIAL PRINCIPLES OF THE DOCTRINE OF CAPITAL MAINTENANCE**

Due to limitation in the shareholders' liability and the possibility of insolvency of a company, a major concern in the financial matters of companies with specific regards to its liquidity and liability, is the creditors' protection. Expectedly, this led to the development of the doctrine of capital maintenance. The doctrine is composition of rules put in place for ensuring that the obtaining of purported capital which a company claimed it has, is obtained. Besides, it is also essential for maintenance of the company's capital, in protecting and preserving the company's creditors' benefit. Below are the fundamental guiding principles.

1. ***That valuable consideration for shares issued by the company must be obtained*** Some statutes regulating the formation and operation of companies require that the company board of directors, in issuing authorised shares, should ensure the payment of adequate consideration, as determined by the board, for the shares. Although consideration need not be cash, may be in the form of service rendered, other valuables and exchange of goods or property, the issue of adequacy or adequate value is sacrosanct and indispensable. Where issuance of shares is to be made in exchange of services which is to be rendered at a future date, it is advisable that such shares should be held in escrow pending the rendition of such services. Shares must not, as a matter of law, be issued for an amount lesser than its actual value.<sup>23</sup> It is a breach of fiduciary duty. If so issued, the directors are liable to the company for acting *mala fide* against the interest of the company who in turn owes its creditors a duty of good faith.
2. ***That the return of paid up share capital to the company's members is prohibited***<sup>24</sup> It is a fundamental principle of the doctrine of capital maintenance that paid-up share capital must be maintained and it should never be returned to the shareholders. A company can only make return of its paid up share capital to its shareholders, either by leave of court, or by special procedure, otherwise such return is void and *ultra vires* and therefore the shareholders cannot validly ratify or approve same.<sup>25</sup>
3. ***That shareholders liability in respect of capital not paid up on shares must not be reduced***<sup>26</sup> A shareholder's liability is limited only to the aggregate value of the unpaid part of his total subscribed shares. Where a shareholder has paid up all, he is no more liable to the debt of the company. However, there are situations a member might have subscribed to certain number of shares but the company may not have been in need of the total sum and may only call for payment of 50%. The amount called for is the called up capital while the amount actually paid by each shareholder is the paid up capital. The difference between the paid up capital and the total sum of shares subscribed is the value of the

<sup>23</sup> In re: Exchange Banking Co. (Flitcrofts' case), (*Supra*)..

<sup>24</sup> Hoffman J. in Aveling Barford Ltd. .v. Perion Ltd. (1989) 1 W. L. R. 360 at p. 364; see also In re: Exchange Banking Co. (Flitcrofts' case), (*Supra*)..

<sup>25</sup> *ibid*

<sup>26</sup> Geoffrey Morse, Charlesworth and Morse: *Company Law*, (1991) 14<sup>TH</sup> Edition, London: Sweet & Maxwell, P. 190.

liability of the shareholder.<sup>27</sup> Shares subscribed must always be paid for. Until paid, it remains a debt to the company.<sup>28</sup> To reduce or cancel unpaid capital, is reduction of share capital and the doctrine disallows it.

4. ***That a company must not purchase its own shares***

It is a basic principle in common law that accompany must not purchase its own share.<sup>29</sup> In Bangladesh generally, no company limited by shares is allowed to purchase its own shares except in a manner prescribed by the Companies Act, 1994. This procedure is also applicable to Nigeria. It is evident to note that, in both countries, a company can validly purchase its own shares from its profit capital in accordance with the individual its company law. In Nigeria, a company can; but, the purchase could be made only from the company's profit which otherwise would have been declared as dividends. Besides, the purchase could also be from the proceeds of a fresh issue of shares made for that purpose only.<sup>30</sup>

5. ***The repurchase of redeemable shares shall only be made at price not more than the lowest price at which they are redeemable***

Redeemable shares<sup>31</sup> shall not be bought at a price more than the minimum price at which they are redeemable or shall be redeemable at the next date thereafter at which they are mature for redemption.<sup>32</sup> The jurisprudence of the provision as a principle of the doctrine of maintenance of capital is that where redeemable shares are purchased for prices higher than the minimum redeemable price, it would amount to paying more than the shares actually worth. This could be a fraud on the company the implication is that it depletes the capital base of the company and might affect its ability to satisfy its obligation to its creditors.

6. ***That a company must not issue shares at a discount***

In Nigeria,<sup>33</sup> in the company of a class of shares, issued already, issuance of share at a discount is unlawful, except where the issuance is with an approval passed though its court sanction resolution. Additionally, the highest rate of discount at which the company would issue shall be specified in the resolution. Any such shares whose issuance at a discount has been approved, must be timeously issued.<sup>34</sup> The particular of the discount allowed on issuance of shares with the sum of such discount yet to be written off shall be contained in the prospectus relating to the share. The jurisprudence behind this provision is that where shares are issued at discount, it trades off some of the actual value of the

<sup>27</sup> Called –up share capital is the amount of the authorised share capital that the company has demanded payment for from shareholders.

<sup>28</sup> Rambarran Mangal *An Introduction to Company Law in the Commonwealth Caribbean*, (2000), Bardos: University Press of West Indies.

<sup>29</sup> Trevor v Whitworth (*supra*).

<sup>30</sup> Section 161(a) Companies and Allied Matters Act, *op. cit.*

<sup>31</sup> These are some shares that are issued by the company on the condition that it will, or may, repurchase them at a in the future. It may be on a fixed date. for instance, it may stated that the company shall redeem those shares ten years after the issuance or at the discretion of the directors. Usually, the redemption price is often the same as the price of issue. However, this may not be so. This can be a way of making a clear arrangement with an outside investor. Available at <<http://www.companylawclub.co.uk/classes-of-shares>> accessed 22 September 2019.

<sup>32</sup> Section 161(b) of Companies and Allied Matters Act, *op.cit.*

<sup>33</sup> Section 121, *ibid.*

<sup>34</sup> This must be done within the month from the date on of the court's sanction or within such extended time as be allowed by the court.

shares to the advantage of the purchaser, hence it reduces that capital base of the company.

7. ***That a company must not pay dividend from its capital***

Payment of dividends to the shareholders shall only be made from the profit of the company which is distributable. Such payment is however, in accordance with the provisions of this Act.<sup>35</sup> Distributable profit are profits made in the course of using the property of the company notwithstanding whether or not the property is a wasting-assets; revenue reserves; profit on a fixed asset sold, but where more than one asset is sold, the net realised profit on the assets sold. In England, the definition of profit with regard to payment of dividend from profit, includes the Nigerian definition but adds that the profit must not have been previously utilized and the profit is minus its known losses put together which are yet to be written off previously, in a reduction or reorganization of capital duly made.<sup>36</sup>

8. ***That a company must not grant financial assistance to person for the purpose of purchase of its own shares***

Especially in Nigeria, no company or its subsidiary is allowed to give financial assistance to a person acquiring or proposing to acquire the company's shares from it,<sup>37</sup> directly or indirectly, for that purpose. This prohibition extend to a contemporaneous financial assistance in situation where there is a liability yet to be settled, incurred (by him or any other person), because of the acquisition; or financial assistance given by the company or any of its subsidiary, in whatever manner in order to reduce or discharge the liability so owed by such person. There seem to be no any form of exception to the rule as such assistance is contrary to the interest of creditors.

In the UK, the same prohibition holds sway but with some exception. Over there, where principal purpose of the company's giving the assistance is not for such acquisition, the law does not disallow the giving of financial assistance to enable a person acquire shares in the company or its holding. This include situation where such gift of the assistance for the acquisition is only ancillary to some larger purpose of the company, provided the assistance is given in good faith and in the interests of the company.<sup>38</sup>

9. ***That a subsidiary company generally must not be a member of its holding company***

10. ***That accompany must not alter its object clause***  
S. 46 of CAMA.

## 5.0 EXCEPTIONS TO THE PRINCIPLES OF THE DOCTRINE OF CAPITAL MAINTENANCE

The doctrine of Capital maintenance which cut across some jurisdictions such as United Kingdom, Nigeria etc, prohibits, subject to certain exceptions or under certain conditions, the

<sup>35</sup> Section 379(5) CAMA; see also section 830(1) of the UK C A 2006.

<sup>36</sup> Section 830(2) UK Company Act 2006

<sup>37</sup> In Nigeria, an indemnity, gift, security or guarantee, loan, or any form of credit is deemed as a financial assistance. This also extend to Financial assistance made by a company made, whose net assets are by that assistance reduced to a material extent or which has no net assets. Financial Assistance therefore includes a gift, guarantee, security or indemnity, loan, any form of credit and any assistance, financially given by a company, the net assets of which are thereby reduced to a material extent or without net assets. See Section 159(1) CAMA. The definition, in the UK, cover the Nigerian definition and extends to any other financial assistance given by a company where the net assets of the company are reduced to a material extent by the giving of that financial assistance, or the company has no net assets. See Section 677(1) (d) of UK Company Act 2006.

<sup>38</sup> Section 678 (2) of the UK CA 2006.

reduction of share capital of a company.

A company may redeem its shares if permitted by law. Where it is permitted, the condition of such redemption may be stated. For instance, a company is, in a prescribed manner and in accordance with the provisions of the law, allowed to buy its own shares and after paying its debts in a winding up, it may also return its capital, to its members. In a proper capital maintenance practice, payment of profits can only be recognised, at least, after maintaining from the business, the amount of the company's net assets (i.e., capital) during the concerned business period a business has, at least. Profit, therefore is aggregate increase in net assets of the company during the concerned period of time.

## 6.0 APPLICATION OF THE DOCTRINE OF CAPITAL MAINTENANCE IN NIGERIA

Since the share capital of a company is treated as a fund that must be protected for the benefit of the shareholders and the creditors, that law ensures that the allottees pay their nominal value in full, although, a company may issue partly paid shares on allotment and call-up the rest later. Shares may also be issued at a premium. A company cannot however, give away its shares; although, it may issue bonus shares to members. Shares are issued in return in for cash or assets except in certain circumstances permitted under the law.<sup>39</sup>

### a. Issuance of Shares at a Discount

Section 121<sup>40</sup> prohibits the issuance of the company's shares at a discount i.e., less than its nominal value. Such an issuance, if done, is void. The law however, concedes issuance of shares at a discount as lawful if it is authorized by a resolution duly passed and supported later by court's sanction. The highest rate of the discount for the issuance of the share must be specified in the resolution. Finally, those shares to be issued at discount must be issued before the lapse of one month from the resolution receives court's sanction or such other extended days as the court may so allow. A prospectus shall thereafter be issued containing the all information relating to, so much discounts was conceded at the issuance or what sum of any such discount was already written off, as at the date of the issue of the prospectus shall be contained in the prospectus.

### b. Increase of Share Capital

Under Section 102,<sup>41</sup> a company, in its general meeting may, whether or not a company's shares have been converted into stock, add fresh shares of such sum as it may desire, in order to increase its share capital. However, within 15 day of the resolution authorising the increase, the notice there shall be communicated to the Corporate Affairs Commission. For the increase to be effective after the passage of the resolution, 25% of the share capital as increased, must have been issued and there is delivery of a statutory declaration evidencing the issuance, at the Commission.<sup>42</sup>

### c. Power to Pay Interest out of Capital

When a company wishes to raise money by issuance of shares to pay expenses for the construction of any works, buildings and plant which may not be made profitable for a long period, the company may,, where the amount paid would not reduce paid-up capital, pay interest, not exceeding normal banking rate, on so much of the share capital and charge the sum as part of

<sup>39</sup> Section 27 (2) of the CAMA, *op.cit.*

<sup>40</sup> The CAMA, *ibid.*

<sup>41</sup> *ibid.*

<sup>42</sup> *Ibid* at section 103.

the cost of such works, buildings or machinery provided this is authorised by the company's articles; and passed by a special resolution so authorizes. A notice of this shall however, shall be given to the commission who may cause it to be investigated before approving it.

#### d. Serious Loss of Capital

Section 112 of the CAMA,<sup>43</sup> places a duty of disclosure on any of the Directors of public company as soon as he discovers the company's net assets represent 50 % or less of its called up share capital, are lost.<sup>44</sup> Within 30 days from the date of the discovery, the directors are required to convene to consider if there was indeed any such loss any. Where the loss is confirmed, they are required to summon a meeting within 60 days to decide the measure to be taken. The date for the meeting not not be later than 60 days from that day, where the directors failed to summon the meeting, each of them is liable to a fine of ₦500.00.<sup>45</sup> This section is intended to protect the company's assets from reckless diminish without a diligent intervention.

#### e. Payment of Commission and Discounts Out of Shares and Capital

Section 130 of the CAMA<sup>46</sup> restrains a company (either directly or indirectly) from appropriating its shares or capital, for paying to any person, any commission or discount or allowance as an entitlement for taking up or agreeing to take up the acquisition of any shares in the company, in whatever manner; or for procuring or agreeing to procure subscription, in whatever manner; or for any shares in the company, whether the shares or capital money are so applied by its addition to the cost of purchase of any property which the company acquired or to the contract price of any work which the company intend executing, or any such money paid from the nominal purchase money or contract.<sup>47</sup> The payment of commission out of the company's capital could be regarded in certain respect as an issue of shares at a discount. The implication of of a company issuing its shares at a discount is that there is a reduction in its capital other than as permitted by the Act.<sup>48</sup>

In *Ooregum Gold Mining Co. of India .v. Roper*,<sup>49</sup> where a company issued shares of £1 each with 15s credited as paid thus requiring the allottees to pay, in effect, only 5s for a share. It was held that the issue was *ultra vires* the company and that the allottee must pay the full price of the shares.<sup>50</sup>

However, for this reason, section 130 has expressly provided that except in circumstances provided for under section 131 of the Act.<sup>51</sup> Thus section 131 of the Act<sup>52</sup> permits payment of commissions and discounts to any person, for subscribing or agreeing to subscribe, absolutely or conditionally for any of the company's shares, where ever the company's Article authorises such payment which does not exceed

<sup>43</sup> *Ibid.*

<sup>44</sup> Deji Sasegbon & et al: *Nigerian Companies and Allied Matters Law and Practice*, I(keja: DSc Publications Ltd., 1991) p. 184.

<sup>45</sup> See CAMA, section 112.

<sup>46</sup> *Op.cit.*

<sup>47</sup> *ibid.*

<sup>48</sup> Deji Sasegbon & et al.; *op.cit.*, p. 205.

<sup>49</sup> (*Supra*), It was however held n this case that a company may issue its share at a lower price than the market price, provided the issued price is does not fall below its nominal value. See also *Hilder .v. Dexter* (1902) AC 474. See further *The Nigerian Company Law and Practice* by Orojo (London Sweet & Maxwell, 1976) Pp. 167-174,

<sup>50</sup> *Ibid.*

<sup>51</sup> See the CAMA, *op.cit.*

<sup>52</sup> *Ibid.*

10% of the price at which the company issued the shares or the amount or rate authorized by the Articles or whichever is lesser. In this situation, the rate or amount of the commission which is paid or agreed to be paid is either, where the shares are offered to the public for subscription, disclosed in the prospectus; or where shares are not offered to the public, disclosed, in the statement in lieu of prospectus or statement in the prescribed form duly signed and delivered before paying the commission. The total number of shares whose commission, the persons agreed to subscribe, will also be disclosed.

Until the whole amount is written off, every company's balance sheet shall contain the amount paid as commission or so much of it as has not been written off, shall be stated in every balance sheet of the company.<sup>53</sup>

#### e. Share Reduction

Section 105(1) does not permit share capital reduction. Section 106 however, permits a reduction of a company's share capital, through a special resolution known as 'resolution for reducing share capital' authorised by the its Articles and confirmed by court. Thus, a company may extinguish or reduce the liability on share capital not paid-up; or cancel any paid up shares whether lost or lost or unrepresented by assets; or otherwise pay off any paid-up share capital not really needed by the company. In any of these cases, the company alters its Memorandum by reducing the amount of its share capital and of its shares.

The company may by an application to the court, after passing the resolution, seek the confirmation of the reduction.<sup>54</sup> The resolution is ineffective until it is confirmed by the court and a copy of such resolution is filed with the Corporate Affairs Commission. The words 'and reduced' may be added to the name of the company.<sup>55</sup> Where the proposal for a share reduction involves either diminution of liability relating to unpaid share capital or the payment to a paid-up share capital's shareholder and in any other case, if by the direction of court, then Sections 107 (3), (4) and (5) shall be applicable.

Section 107 (3) provides that every company's creditor who is owed any debt or who has a claim against a company, could object to its capital reduction if, at the date fixed for application for the capital reduction were to be for the commencement of the company's winding-up, the court would allow the proof of such debt or claim against the company.

Section 107 (4) empowers the court to settle a list showing the names and the nature of the claims of creditors who have the right to object. The court will also invite by notices, other creditors not yet listed but having appear on the date fixed by the court to enable their claim to be so entered or otherwise be excluded from the right of objecting to the reduction of capital.

The section further emphasizes in sub-section (5) that, the court's discretion of dispensing with the creditor's consent for the capital reduction, upon the company, securing payment of his debt/, where the company admits owing whole debt claimed or, without admitting, but is willing to have the claim settled, by appropriating the full amount of the debt or claim; and where there is no admission nor the company disposed to providing for the full amount of the debt or claim, or, where, the amount is contingent or not ascertained, then an amount fixed by the court at the close of its enquiry and adjudication in a like manner as the case of the company's winding up.

#### f. Issue of Shares at A Premium

Section 120 states that where shares are issued at a premium, the company will move to a Share

<sup>53</sup> Section 132 of the CAMA, *ibid*.

<sup>54</sup> *Ibid*, section 107 (1)

<sup>55</sup> *Ibid*, section 108

Premium Account, a sum equal to the amount of the premium.

The use of Share Premium Account may either be for paying up of the company's unissued shares, to be issued to shareholders as fully paid bonus shares; or in settling of the company's preliminary or formation cost, and the costs of or the commission paid or discount allowed on any of the company's issue or in providing for the premium payable or redemption of any redeemable share of the company.

**g. Issue of Redeemable Preference Shares**

Where, allowed by its Articles, a company limited by shares may issue shares which shall, at the opinion of the company, be liable to be redeemed.<sup>56</sup>

**h. Purchase by a Company of its Own Shares and Financing the Purchase**

Generally, a company cannot acquire its own share for the reason that this may allow Directors to manipulate share values depending on the price.<sup>57</sup> Section 161 provides that:

Notwithstanding any provision in the Articles, a company may acquire its own shares:

- (i) out of the profits available for dividend or the proceeds of a fresh issue of shares made for the purpose of the purchase. In the latter case, payment out of proceeds of fresh issue, the difference between the nominal value of those shares and the proceeds of a fresh issue must be transferred to Capital Redemption Reserve;

- (ii) redeemable shares shall not be purchased at a price greater than the lowest price at which they are redeemable or shall be redeemable at the next date thereafter at which they are due or liable to be redeemed;

Section 162<sup>58</sup> which deals with the minimum number of shares acquired states that no company shall enter into a transaction in which the total number of its shares, or of its shares of any one class held by persons other than the company or its agents less than 85% of the total number of shares or of shares of that class which have been issued. This will however not include redeemable shares. Where there is a reduction of the number of any shares, after the issuance of any class of shares, then section 162 shall apply as, if, the number originally issued (including share of that class cancelled before the reduction took effect) had been the number as so reduced. Section 160(2) allows a company to acquire its own own shares for certain purposes. These are to: settle an agreement of the company; pay any claim from a dissenting shareholder, to ensure the order of court is complied with; eliminate fractional shares; or debts or claim settlement or compromise as asserted by, or against the company.

**i. Financial Assistance by a Company for the Purchase of its Own Shares**

Section 159(1) of the Companies and Allied Matters Act<sup>59</sup> prohibits the company from giving financial assistance for acquisition of its shares. If a company allows its assets to be so used in this manner, it may lose them, if, the purchaser turns out to be illiquid, poor or bankrupt. The rule does not however, prohibit:

- (i) a company from giving financial assistance for the purchase of shares in its subsidiary. This may, however turn out to be a bad investment since it may affect the company's creditors and shareholders adversely although it may not harm the

<sup>56</sup> *Ibid*, Section 122.

<sup>57</sup> *Ibis*, section 161.

<sup>58</sup> The CAMA, *op.cit*.

<sup>59</sup> *Ibid*.

- interests of the subsidiary's shareholders;
- (ii) where a company carries on the business of money lender, it may, within its normal course of ordinary course of business, lend money to persons who may use such loan to buy share in the company;
- (iii) giving of loans or overdraft to person in the lawful employment of the company who are not its directors for purchase of the company shares;
- (iv) the provision of money by a company in good faith, of financial assistance for the purposes of an employees' (including directors holding salaried employment) share scheme.<sup>60</sup>

#### **j. Dividends**

Shareholders' legitimate expectation is the receipt of dividends whenever there is a profit made from the company's trading. Once the dividend is declared, there is a debt owes the shareholders by the company.

Dividends are declared as provided by the Articles which authorise the Directors to recommend declarations after ensuring retention of sufficient profits to adequately serve as reserves for the business. Section 381 allows the non-declaration of dividends by a company, where, there is a good reason to believe that after the payment, the company will be not be able to settle its debts when they are due. Dividends of a company are payable from:

- (i) gains made from the use of the property of the company; though the property consists of assets that are wasting;
- (ii) revenue reserves; and
- (iii) profit realised on sold fixed asset; but if the asset sold is more than one, the net profit realized on the assets sold.<sup>61</sup>

The undistributable reserves of the company consists of Share Premium Account and the Capital Redemption Reserve. It also includes other reserves from which a company is not allowed, by law or its Memorandum, to make distribution.

The Article of Association usually give the directors power to pay an interim dividend. This is a dividend declared before the close of the company's financial period. Such a dividend could be paid from accruing profits, or out of profits brought forward from a previous period. However, an interim dividend may only be paid by the directors where its payment appeared justifiable by the company's profits available for distribution. The payment of an interim dividend does not require the approval of a general meeting and therefore it does not create a debt due from the company. Thus if the company fails to pay the interim dividend, the members cannot sue the company.

Dividends are normally payable to the shareholders in proportion to their shares nominal value. No account is taken of any premium paid on the shares or of the amounts paid up on the shares. In companies that has different classes of shares, the shareholders will usually have different rights to dividends. If there are preference shares, the preference shareholders must usually be paid first before ordinary shareholders are entitled to their dividend.

<sup>60</sup> *Ibid*, section 159

<sup>61</sup> *Ibid*. section 380 (1).

Dividends, except the articles provide otherwise, must be paid in cash. A shareholder can restrain a company from paying him in any other way.<sup>62</sup> In practice however, the articles may provide that dividends may be paid to members by cheque. Such cheques, called dividend warrants, must be accompanied by a statement in writing showing the amount of the dividend and the amount of the tax paid by the company in respect of the dividend.

Unless the company's articles state otherwise, dividends are payable only to the persons who are registered as members on the dates when the dividend is declared. The company will usually close its register of members some time before the dividend becomes payable, so as to enable it to carry out all the administrative work relating to the payment of dividends. During this period the company will not register transfers of shares, and the dividend will be paid to members registered on the date when the register is closed.

Nigerian shareholders have called on the Federal Government to review the law to attract foreign investment<sup>63</sup> and urged the various accountants and tax consultants in the country to call the Federal Board of Inland Revenue to order on the tax system in the country. They do not want the situation whereby companies after paying their corporate tax are still taxed on funds taken out of their reserves to pay dividends. The provisions of our tax laws, which levy tax on the dividends paid where the company has dipped into the reserves to augment payment are punitive.

Section 15 A of the Companies Income Tax Act<sup>64</sup> provides that the tax rate be applied on the dividends proposed but not on profit. A review of this aspect of the law, which is inconsistent with the current quest of the government in attracting foreign investors is worthy of consideration. This will enhance the level of investment capital. The 10 percent currently being charged constitutes a drain on returns on investments.

Withholding Tax is an income tax, paid in advance. Its purpose is to bring the prospective taxpayers into the tax-net, thereby widening the income tax base. Put differently, the withholding tax system is aimed at tracking down tax-evaders and the incomes which they, otherwise may conceal. When the income on which withholding tax is deducted at source is finally brought to the notice of the tax authority, an appropriate tax is computed. Besides, due credit is given for the withholding tax deducted at source on the presentation of the original withholding tax receipts, through the issuance of credit notes. The taxpayer will only need to pay the balance due after matching the actual tax liability against the credit for the withholding tax severed at source.

There are a lot of people who collect dividend and other income including rents who never pay any taxes whatsoever and there is no way of tracing them or finding them. Income from all sources regardless whether it is from salaries, dividend or rent should be reflected in the tax return form - upon which assessment is made. Once that is determined, the tax payer can then take the receipt on withholding tax on dividend as a credit towards that overall tax he is supposed to pay.

Therefore, withholding tax *per se* is not a tax in its own right, it is a mode of collection of tax and it is devised to ensure that those who are taxable in Nigeria eventually pay their taxes. It can

<sup>62</sup> Wood .v.. Odesa Waterworks Co (1889) 42 Ch. D 636.

<sup>63</sup> See *theBusinessDay (Nigeria)*'s publication entitled "Rising Taxes , Charges Making Nigeria Poorer " published on 3<sup>rd</sup> November, 2019 hosted at <https://www.pressreader.com/nigeria/business-day-nigeria> /20191103/281844350438111. accessed on 11/11/2019.

<sup>64</sup> See the Company Income Tax Act Cap C 21 Law of the Federation of Nigeria, 2004.

therefore be used as a credit, not as tax payable. However, quite a number of shareholders are either ignorant of the intent and purposes of withholding tax or not honest enough to declare all their incomes including dividend to the extent that they could establish a credit in their favour. The principles enumerated above as applicable in Nigeria, are protective mechanism invented by law, for the promotion of a sustainable investment. It has dual purposes. First, it is a preventive measure against sudden collapse of companies as a result of diminution of company's assets, thereby allowing predictability in corporate practice; secondly, to enhance economic development and investment stability for shareholders and company creditors.

## **7.0 CONCLUSION AND RECOMMENDATIONS**

Capital maintenance rules has been entrenched in corporate finance law practice, for more than a century. The rules are, by no means, detailed and complex. It is probably fair to say that they have survived the tide of time through occasional regulatory and judicial review. Having not yet been subjected adequately, to any systematic analytical review in Nigeria, it is imperative that the corporate law and practice in the country have the opportunity of leaning on the stable template firmly built and put in place in the United Kingdom where the doctrine has grown steadily and put in active use for well over two decades. The provisions of corporate laws on repurchase of share, in some respects, appears to be too weak and less effective. Although, financial practitioners and corporate professionals still have much work to do, by effective exploitation without overdependence, in developing the law of practice relating to share repurchases, we have nevertheless, made considerable progress in improving on this concept.

A limited company should expressly not be allowed to reduce its capital. It should also be prevented from purchasing its own shares except save as may be permitted by law under an equitable protective procedure. Since it is not always too possible in Nigeria with its complexity, to observe by courts, all the situations where it would need to protect equitably, the interests of a section of shareholders or a creditors who are unduly prejudiced as a result of capital reduction, there ought to be put in place, the provision of certain mechanisms that would enhance the court's independent assessment, from which it could rightly discern appropriate justification of the reduction scheme.

It is hereby suggested that in some situations, for instance, where the reduction arose from cancellation of paid up share capital which has become spent or is made up of such intangible assets such goodwill, obtaining of the court's sanction, needs not be so essential. This, no doubt, will save the parties' time and prevent undue expenses too. Conclusively, one can contend that the national legislations of both countries must be comprehensively and holistically amended pragmatically to ensure that a company with a share capital raised and subsequently makes no return to its shareholders unless net assets are retained which equal or exceed the value of that capital, is not allowed to use this technicality, perpetually, as a scourge, to deny them of the expectation of profits.

In addition to these the foregoing general suggestions, it is in particular recommended for Nigeria that there should be:

- a) regular review of corporate law, from time to time, with a view to bringing it in conformity with current reality;
- b) a coordinated synergy between regulatory agencies, in putting in place, adequate monitoring mechanisms for ensuring compliance with the law;
- c) constant review of all aspects of the law, which is inconsistent with the current quest of the government in attracting foreign investors is worthy of consideration; and

- d) immediate overhauling, by the the Federal Government of Nigeria, of all existing policies and tax laws, with a view to removing multiple taxation and other area of overlapping tax regime in the country. This will, no doubt, attract in no little way local and foreign investments to Nigerian economy.

It is our belief that the above recommendations will, when diligently pursued, go a long way in strengthening the practice of capital maintenance and financial practice.

## INTRODUCTION

Small and medium-sized enterprises (SMEs) are globally recognised as one of the key economic growth facilitators in developing economies. This potential of SMEs is however limited by the inability amongst many institutions to secure funds for the growth of these businesses. This is mostly as a result of the poor confidence financial institutions and lenders have in the ability of SMEs to repay loans, and in many instances, the absence of reliable financial records to evaluate the viability of SMEs. This calls for an alternative approach at sourcing funds for SMEs and any business experiencing similar challenges. Factoring offers this alternative because it is not a traditional loan and is not limited by the terms peculiar to loan agreements and thus has opportunity for growth in Nigeria. Reports indicate that the world factoring industry is a \$2.3 Trillion Business.<sup>1</sup> Africa however remains left out despite the huge benefits. Specifically, Nigeria has no legal framework for promoting factoring or which boosts the confidence of financial institutions to lend or finance SMEs. Perhaps this is because of lack of appreciation and understanding of the potentials of factoring as a viable alternative to funding SMEs.

A careful study of factoring as a source of funds for SMEs and its various benefits suggest however that it is time Nigeria explores this avenue to encourage business startups, SMEs and cash-strapped businesses. Nigeria however is yet to embrace this great opportunity despite the

<sup>1</sup> AffirmBank, AffirmBank Offers Factoring to Ease Access to Financing for African SMEs, <https://www.affirmbank.com/press-releases/affirmbank-offers-factoring-to-ease-access-to-financing-for-african-sme/> (March 2018).  
<sup>2</sup> L.L.B. L.L.M. Ph.D. B.L. Senior Research Fellow, Legal Research Division, Department of Legislative Support Services, National Institute for Legislative and Democratic Studies, National Assembly, Abuja.  
<sup>3</sup> United Capital, Regional Conference on Factoring in 2014: World Factoring Industry 2.3 Trillion Business, <https://www.factoring.com/world-factoring-industry-2.3-trillion-business/> (United Capital, 9 April 2014) <<https://www.factoring.com/world-factoring-industry-2.3-trillion-business/>> accessed 22 November 2018.  
<sup>4</sup> World Factoring Industry 2.3 Trillion Business, <https://www.factoring.com/world-factoring-industry-2.3-trillion-business/> (World Factoring Industry 2.3 Trillion Business, 22 November 2018).