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# Revenue & Customs Brief 54/07

## Meaning of Ordinary Share Capital

HMRC has been asked to provide a list of foreign entities that it considers to have 'Ordinary Share Capital' for the purposes of Section 832 ICTA 88. Unfortunately as each case will have its own particular set of facts it is not feasible for an exhaustive list to be created, nor, in the context of considering legal systems other than the UK's, that are subject to change, would it be practical to do so.

Set out below is HMRC's interpretation of Section 832 ICTA 88 and information that, it is hoped, will be useful to companies and advisors, as well as officers within HMRC, in deciding whether a particular non-UK entity has 'Ordinary Share Capital' for the purposes of section 832 ICTA 88. Also included below are some details of our position on two of the most often queried foreign entities, the Delaware LLC and the German GmbH.

Please note, this brief only seeks to consider the meaning of 'Ordinary Share Capital' for the purposes of section 832 ICTA 88. Specifically, it does not cover the classification of a foreign entity for UK tax purposes (whether it is "transparent" or "opaque"). Information on that topic is contained in [Tax Bulletin 83](#) published in June 2006.

The reader should also note that the Companies Act 2006 received Royal Assent on 8 November 2006 and the Government has announced its intention to commence all parts of the act by 31 October 2008. The DBERR has published an implementation timetable according to which the relevant sections of Part 17, A Company's Share Capital, will come into force on 1 October 2008. This article will be reviewed in due course to ensure it takes account of any necessary amendments due to legislative changes.

## Definition

Ordinary share capital is defined in Section 832 ICTA 88 as follows:

"ordinary share capital", in relation to a company, means all the issued share capital (by whatever name called) of the company, other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the profits of the company;

This definition therefore includes all of the issued share capital of a company, apart from capital carrying a right to a dividend at a fixed rate only. The bracketed wording "by whatever name called" should not be overlooked as it is important to note that companies often categorise share capital into shares bearing different names, eg A Ordinary; B Ordinary, for purposes which may be of no relevance to the application of the definition above.

## Characteristics of issued share capital in a UK company – general principles.

### UK Companies

Ordinarily, references to a company will be understood to mean a limited liability company. Limited liability companies are so called because the liability of each shareholder for the company's debts and other liabilities is limited to the amount which remains unpaid on his shares. There are two types of limited liability company in the UK, public and private. The main difference between these types of company is that a public company can apply to be listed and offer its shares to the public in order to raise capital.

There are, however, other types of less commonly used company forms: unlimited companies, with or without share capital, and companies limited by guarantee.

In the latter case the members' liability is limited to amounts they undertake to contribute in the event of a winding up; the amount of this maximum liability of each of the members will be set out in the

"guarantee clause" of the company's memorandum. The total commitment of the members, taken together, is known as the "guarantee fund"; this fund only comes into existence on a winding up. In practice, this form of vehicle is usually unsuitable for most businesses but is often used, for example, by charities.

Companies limited by guarantee incorporated on or after 22 December 1980 cannot also have a share capital (Section 1(4) Companies Act 1985). Companies limited by guarantee incorporated before that date may, however, also have share capital.

In 1999 the Special Commissioners considered the status of 'founders' deposits' with a company limited by guarantee in the case *South Shore Mutual Insurance Co Ltd v Blair* 1999 STC (SCD) 296. They came to the conclusion that the deposits were not issued share capital; the company did not, in fact, have any authorised share capital and, as a consequence, could not have issued share capital. Although the decision is not binding authority, the case contains a useful review of some of the authorities about share capital.

## Shares in UK Companies

A company limited by shares is currently required to stipulate the maximum share capital the company may issue and the number and nominal value of the shares into which it is divided, its "authorised share capital", in a document called the company's memorandum of association (section 2(5)(a), Companies Act 1985).

### Note

The reader should note that the Companies Act 2006 abolishes the requirement for a company to have an authorised share capital by the repeal of section 2(5)(a). This should take effect from 1 October 2008. The new act nonetheless requires that, on formation, a company with a share capital will be required to submit a statement of capital and initial shareholdings to the Registrar at Companies House.

The memorandum is one of two essential documents that must be filed at Companies House on incorporation, the second is the company's articles of association; these documents together set out provisions governing the manner in which the company will operate. The amount of authorised share capital set out in the company's memorandum may be later increased by an ordinary resolution of the shareholders (requiring a simple majority of the vote).

The company's assets are owned by the company itself, not by the shareholders individually, although in turn the shareholders together have ownership of the company. The shares express the shareholders' proprietary relationship with the company.

In principle, shares are transferable, but in practice there are often restrictions on transfer, found in the company's articles of association.

The principal rights that usually attach to a share are rights to dividends declared, a right to vote and a right to share in the company's assets in a winding up. The principal responsibility that attaches to a share is to pay what is due on the share. The rights and duties are all subject to the memorandum and articles of association.

For a company limited by shares, the share capital must be stated in a fixed amount. In *Ooregum Gold Mining Co of India v Roper* [1892] A.C. 125 Lord Halsbury said

'The capital is fixed and certain, and every creditor is entitled to look at that capital as his security.'

A share certificate is prima facie evidence of ownership of a share. However, it does not, of itself, constitute ownership of the share and is not essential to demonstrate that share capital has been issued. In order to be a member of a company, under the Companies Act, a person must be entered in the company's register of members. See s22, Companies Act 1985 (s112 Companies Act 2006). The decision in *National Westminster Bank plc v CIR* ([1994] STC 580), confirms this position, i.e. the 'issue' of share capital is only complete when members are recorded in the company's register of members.

## Characteristics of issued share capital in a body incorporated in another country – relevant factors

When looking at whether a body incorporated under the law of another country, it is self evident that UK company law is not directly applicable. In *Ryall v The Du Bois Co Ltd* 18 TC431, Lord Hanworth M.R. said

'a share in a foreign company may be something different from and, indeed, is almost necessarily different from, a share as we know it in an incorporated company.'

Slesser L.J. said

'we have to consider what would be analogous to stocks and shares in Germany in dealing with what is a company, and allowing for differences of law in that country'.

Slesser L.J.'s comments were given in the statutory context of whether foreign income was income from stocks and shares for the purposes of Case V Schedule D. However we consider them as authority for proceeding by analogy in deciding whether the capital of a foreign company can be considered as 'issued share capital'.

A number of factors are relevant in deciding whether or not a foreign 'company' has 'issued share capital'.

Firstly the body concerned must have a legal personality separate and distinct from that of its members, able to carry on business and owning its assets in its own right, in the same way as a UK company. If that characteristic is absent the members cannot have the type of proprietary interest which is characteristic of holders of issued share capital of a company incorporated under the laws of the UK.

If the body concerned possesses a separate legal personality, as described above, the following factors will then become relevant to the question of whether a member's interest in such company is analogous to an interest in 'issued share capital' as understood in the UK:

- whether the member's interest is like shares (that is, a portion of the fixed capital of the corporate body) or like debt (that is, money owed by the body corporate to the members)
- whether any subscription for the members' interests is payable
- whether the subscription payable for the 'shares' remains the member's property or whether it becomes the property of company
- what proprietary rights, such as rights to participate in control by voting, rights to receive a dividend out of the company's profits and rights to share in a distribution out of the company's assets in the event of a winding up, attach to the member's interests and what responsibilities, such as a responsibility to pay up on the 'share' if called, attach to the member
- whether the member's interest can be legally evidenced in accordance with local laws; for example, by being registered in a company-held document, or with a public authority, or by a certificate or similar document
- whether the member's interest is denominated in a stated fixed value
- whether the member's interest forms a fixed and certain amount of capital, or a part of that, to which creditors can look as security
- whether the non-UK law concerned requires amounts subscribed to be allocated to capital of the company which is fixed capital, and the extent to which subscriptions are so allocated
- whether the member's interests is capable of transfer and if so whether such a transfer would be similar to a transfer of a portion of the capital of the company, with attendant proprietary rights, rather than similar to a transfer of money or a loan account; and
- any other factors which point to the member's interests being 'issued' and having the character of ordinary share capital.

The background information a company or its advisers are likely to want to consider includes the following documentation:

- The corporate law of the foreign country which governs the body in question.
- Whatever general commentaries are available on the legal and commercial status of the body in question.
- The documents establishing the body, and any other documents which regulate its activities, especially those which deal with subscription for capital and those which govern what happens to the profits and assets of the body.

The accounts that show the state of affairs of the body, in particular the balance sheet, may be helpful in showing whether, and to what extent, money subscribed or otherwise provided by the members of the body is allocated to a fixed amount of permanent capital or whether it is loan debt.

In deciding whether the body has issued share capital, it is not necessary for every factor to be present, but there should be a preponderance of indicators pointing to there being issued share capital. Different weight may need to be given to the various factors. For instance it would be of considerable importance

if the member's interest had the character of debt. However restrictions on transfer of a member's interest would be of lesser importance. It is by no means uncommon for there to be restrictions on transfer of shares in a UK company.

## Two Common Foreign Entities

### Delaware Limited Liability Companies

There is an article about Delaware Limited Liability Companies (DLLC) in [Tax Bulletin 51](#). Section 18-702c of the Delaware Limited Liability Act provides that

'Unless otherwise provided in a limited liability company agreement, a member's interest in a limited liability company may be evidenced by a certificate of limited liability company interest issued by the limited liability company.'

If a DLLC issues "shares" in this way and the other factors relating to the company suggest that it has share capital then we will accept that these "shares" may be regarded as "ordinary share capital" for the purpose of Section 832 ICTA 1988.

It should be noted that **not** all DLLCs issue share certificates but they may still have "ordinary share capital". Regard must be had to the particular terms of the agreement by which the LLC has been created. In any case of doubt or difficulty regarding the status of the share certificates HMRC will advise in particular cases in line with Code of Practice 10. The contact point is:

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Other States within the United States of America have comparable legislation to Delaware. Where it can be shown that a particular State has legislation analogous to the Delaware legislation with which we are familiar, HMRC would expect to be able to provide advice in line with that for DLLCs.

### Gesellschaft mit beschränkter Haftung – GmbH

A Gesellschaft mit beschränkter Haftung (GmbH) in Germany, literally a 'company with limited liability', is an entity of a very similar kind to a UK private limited liability company. An Aktiengesellschaft (AG), sometimes called a "joint stock company" may be considered more akin to a UK public limited liability company (plc) as its stock may be listed.

Under German law, the capital of a GmbH is not divided up into small units. However, a GmbH has a fixed amount of capital (Stammkapital) which corresponds to the maximum amount of share capital that the company may issue, similarly to a UK limited liability company's "authorised share capital". The amounts originally contributed (Stammeinlagen) by the members (Gesellschafter) will also be noted, just as in the UK the initial subscriber shares will be noted in the memorandum of a limited liability company.

Article 5 of the German GmbH law sets out a minimum amount of Stammkapital (authorised share capital) as €25,000, and the minimum amount of Stammeinlage (original contribution/subscription) of each Gesellschafter (member) at €100.

Based upon GmbH cases HMRC has previously considered, the amounts of Stammeinlage subscribed by the members may normally be regarded as issued share capital for the purposes of the Taxes Acts.

### Note

The above information has been set out in order to assist companies and their advisers understand HMRC's present interpretation of section 832 ICTA 1988 in the context of non-UK entities. The above note reflects our approach as taken in the context of a number of particular cases. Due to the particular facts that will be relevant in each individual case it is not possible for HMRC to offer a general advisory service in respect of other kinds of body throughout the world.

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