

Paying up share capital 3/44/23



Associate, PwC Legal
Karina Daugaviete

In our article of 11 July 2023 “Commerce Act amended” we informed our MindLink subscribers about the extensive amendments of 16 June 2022 to the Commerce Act that came into force on 1 July 2023. In that article we looked at some of the amended clauses of the Commerce Act. This article explores the Act’s rules for paying up a company’s share capital and relevant changes that came into force in the summer.

Paying up share capital when forming a company

Companies are divided into two types: private limited (*SIA*) and public limited (*AS*). Under the Commerce Act, EUR 2,800 is the minimum share capital for a private company and EUR 25,000 for a public company (it was EUR 35,000 before the amendments came into force). For a private company, the Commerce Act makes it possible to adopt a share capital of less than EUR 2,800 if the company meets certain criteria for its board members and shareholders (“low-capital company”). Low-capital companies are required to build a mandatory reserve each year by deducting at least 25% of their profit for the financial year under section 185.1(2) of the Commerce Act.

Before the amendments came into force, the Commerce Act stated that the memorandum of association must prescribe the total share capital and the amount each founder has to pay before the company is entered on the commercial register maintained by the Enterprise Registry. This means that when an application was filed with the commercial register, there could be a situation where share capital did not have to be paid up. For a public company, however, the minimum of EUR 35,000 and at least 25% of the entire subscribed share capital had to be paid up. Some of the share capital could be paid up by a deadline set by the memorandum of association but no later than one year after a private company was entered on the commercial register or after a public company’s memorandum of association was signed. This means that as soon as a company’s share capital was paid up, the shareholders had to file an application with the commercial register serving as the basis for entering the new amount of paid-up capital.

After the amendments came into force, section 146(1) of the Commerce Act states that the founders must subscribe and pay up the entire share capital indicated by the memorandum of association before filing a registration request unless the memorandum sets an earlier deadline. This means it’s no longer possible for the memorandum to lay down rules allowing the shareholders to pay up share capital after the company is entered on the commercial register. Instead, share capital must be paid up before a registration request is filed with the commercial register. While in any case it will be possible for the memorandum to set a deadline for paying up share capital, this will have to be set in a way that ensures share capital is paid up before a request is filed with the commercial register.

An annotation to the draft amendments explains that one of the reasons why such changes are needed is to eliminate the risk of uncertainty for third parties and to avoid misleading them about the actual amount of share capital. Partially paid-up capital also meant the shareholder was given voting power only for shares that had been paid up. Statistics gathered over a particular period show that only a small number of companies chose not to pay up share capital by the date of formation. The amendments equalise the procedures for paying up share capital in private, public and low-capital companies.

Paying up share capital on an increase

The amendments also change the procedure for paying up share capital when it's increased. Before the amendments came into force, the Commerce Act stated that rules on the increase of share capital approved by the general meeting of shareholders must set a deadline for paying up new shares, which could not be longer than six months for a private company and one year for a public company after the general meeting resolved to increase share capital. Similar to company formation, it was possible to increase share capital, enter the increase on the commercial register, and only then pay it up. On paying up, a separate application had to be filed with the commercial register.

After the amendments came into force, sections 202(1) and 261(1) of the Commerce Act state that a share capital increase application must be filed when the payment deadline set by the share capital increase rules expires or after the entire called-up capital has been paid up.

It's important to note that on a share capital increase, the deadline for paying up shares must be set in a way that ensures each share is paid up within six months after the general meeting resolved to increase share capital under sections 198(1)(8) and 257(1)(8) of the Commerce Act.

Consequences of failing to pay up share capital

Section 156 of the Commerce Act lays down special rules for handling cases where shares are not fully paid up by the deadline. In short, the board is required to send a notice of non-payment and set a repeat deadline that must not be shorter than 15 days or longer than 30 days after the notice was sent. Anyone who fails to pay up share capital by the repeat deadline forfeits their share entitlement and those shares become the company's property. Section 156 also lays down other rules on share capital not being paid up by the deadline, including the possibility of the memorandum and articles of association prescribing a contractual penalty for failure to meet the share payment deadline.

For public companies, subsections 260(1) and (3) of the Commerce Act state that if share capital is not fully paid up by the deadline set by the increase rules, the share issue is considered valid only for paid-up shares, with appropriate amendments being made to the articles, unless this sort of increase is contrary to the increase rules. However, if a capital increase or a share issue is declared invalid, the money paid will be refunded to persons having subscribed to the newly issued shares under section 260(2) of the Commerce Act.

The amendments also update the procedure for paying up share capital in cash. Persons forming a company used to be required to open a bank account in the company's name and to arrange for share capital to be paid into it. The amendments state that a bank account may be opened with a payment service provider under section 147(1) of the Commerce Act. This means that the range of "institutions" where temporary bank accounts may be opened for paying up share capital has been widened.

In summary, the Commerce Act's most recent version aims to ensure most companies have their share capital paid up and to avoid any circumstances where it's paid up only partially when a company is formed or when share capital is increased.