



WHAT IS MY SHARE?

By Sundiata J. Gibbs

Becoming a shareholder of a company limited by shares may seem like a simple process.

An eager investor gives a company money (or money's worth) and in exchange, the company issues to him shares which represent ownership.

But is the process truly that simple?

Take for example the following situation featuring the hypothetical investor named "Joe Businessman" (no relation to Joe the plumber).

Joe eats lunch everyday at a small, relatively unknown restaurant near to his house. The red peas soup at this restaurant is the best that Joe has ever tasted and he is convinced that if the establishment moved to a more accessible location and had more money to market its product it could be one of the top restaurants in the island. Joe, without a second thought, decides that he is going to take his savings and do all that he can to become a part owner of this guaranteed "cash cow". The question is: where does he start?

This week's article is aimed at businessmen like Joe who wish to inject capital into a small but promising establishment and want to be assured that any ownership stake that they have acquired is secured.

Ways to become a shareholder

There are three usual ways in which one can acquire shares in a company:

- (a) By subscribing to the Articles of Incorporation (subscription);
- (b) By purchasing shares from an existing shareholder (share transfer); and
- (c) By purchasing shares from the company itself (share allotment).

By doing any one of these three things Joe can acquire the right to have his name entered in the company's books as a shareholder but he should be well aware of the proper procedure that should be followed when pursuing this goal.

Subscription

Even though it can only be done before a company is formed, subscribing to the Articles of Incorporation ("the Articles") is probably the easiest and most definite way for an investor to become the owner of shares in a company. By signing the Articles in the presence of a witness, a subscriber is deemed to have entered into a contract with the company to be an owner of shares. On the date of incorporation, the contract takes effect and the subscriber becomes a shareholder even if the company fails in its duty to place his name in the register book (which is a necessary step in all other cases).

If Joe's favourite restaurant has not yet been incorporated, Joe may wish to discuss the benefits of incorporation with the owners of the restaurant. If they agree to incorporate, subscription would be a preferable option for Joe as it would merely involve his payment of capital and a stroke of a pen.

Transfer

If the enterprise is already incorporated our friend Joe could obtain shares in the company by purchasing shares from an existing shareholder.

However, acquiring shares by transfer has its obstacles. For example, section 75 of the Companies Act makes it unlawful for the company to give effect to a share transfer until a "proper instrument of transfer has been delivered to the company".

If this section is read in conjunction with the Transfer Tax Act (section 33), it is evident that a "proper instrument of transfer" means a document signed by both the transferor and the transferee and bearing a stamp which indicates that all transfer tax and stamp duty have been paid.

What this means for Joe is that he does not automatically become the legal owner of shares by entering into a contract to purchase them from an existing shareholder. For him to actually become a shareholder he would still need to deliver to the company written evidence that a contract existed and was duly stamped by the tax authorities. In addition, when being submitted to the company the contract should also be accompanied by the share certificate of the previous owner of the shares.

Unfortunately for Joe, even delivering a contract affixed with the appropriate stamp duty does not guarantee that Joe will be registered as the holder of the shares. This is because a private company must place restrictions on the right of its shareholders to transfer shares. Restrictions may take any form but in practice the right to transfer shares is usually restricted by either:

- (a) giving a right of first refusal to existing shareholders (this is the right to be offered shares before all others); or
- (b) giving directors the right to refuse to register a transfer.

This means that even if a purchaser of shares does everything by the book, his quest to obtain shares by transfer may be hindered by the directors of the company.

Allotment

An allotment takes place when a company agrees with a potential shareholder to place his or her name on the company register as owner of a specific number of shares. It differs from a transfer in that the shares being allotted to the investor are not previously owned shares (hence there is no "transfer of ownership").

The agreement to purchase the shares need not be in writing (if the shares are being paid for in cash) but the person being allotted the shares must actually have his name placed on the shareholders' register before he can truly call himself a shareholder.

However, our protagonist Joe would be well advised to his due diligence if he is seeking to become a shareholder by virtue of an allotment. When a company is being incorporated, the Articles must stipulate the maximum number of shares that the company is authorised to issue. The company cannot properly issue shares in excess of the maximum stipulated unless the authorised share capital is increased by a resolution passed in a general meeting of shareholders.

Therefore, if Joe's favourite restaurant has only 10 shares available for issue and it purports to allot 20 to Joe without increasing its share capital, the allotment of the extra 10 shares will be considered invalid. Joe would still be a holder of 10 shares but not of the 20 shares that he paid for.

Conclusion

No matter which way Joe chooses to become a shareholder, the Companies Office of Jamaica ("COJ") should be notified of his addition to the shareholder's register. If shares are transferred to him, it should be noted in the company's annual return which is filed with the COJ. If he is allotted shares by the company itself, a Return of Allotment should be filed outlining the particulars of the transaction. In the end, Joe may just decide that he does not want to be a shareholder after all. He may decide to keep his favourite restaurant a secret and to stash his savings safely under his mattress. But hopefully if he does choose to get into the restaurant business, he would bear this article in mind, and he would be able to determine, without a shadow of a doubt, "what is his share".

Sundiata J. Gibbs

Sundiata Gibbs is an Associate at Myers Fletcher & Gordon and is a member of the firm's Compliance and Commercial Departments. He may be contacted at Sundiata.gibbs@mfg.com.jm