4.2. Bookkeeping in Limited Companies

Owners and managers

The main reason for founding a limited company instead of a sole proprietorship or partnership is that the people who put up the capital are usually different from those who actually manage the company. However, it needs to be said that a vast majority of (especially smaller) companies will have shareholders who are also the directors of the company: they start a limited company so as not to be personally liable for the debts of the company.

A limited company is a legal entity – a legal "person" – in its own right, and can be sued for debts owed, breaches of contract etc. But it is a legal entity different from the shareholder or the director, and neither can (in principle) be required to pay money which is owed by the company.

The owners of a limited company are the **shareholders.** The shares will normally carry voting rights in proportion to the number of shares owned.

The shareholders, at their annual meeting, elect directors to supervise the management of their company on their behalf. This **Board of Directors,** often called **Supervisory Board**, is to promote their interests through the governance of the company and also to hire the executive directors (managers) and the MD (Managing Director) respectively the CEO (Chief Executive Director).

The role of the financial statements is crucial since they are the main way in which shareholders who are not involved in the day-to-day operation of the company can see how the managers are carrying out their job. The statutory rules have to be followed as well.

Additionally, limited companies need to have an annual audit, through which their financial statements are checked by an independent firm of accountants who give an opinion as to whether the financial reports give a true and fair view of the business's financial position and recent activity on behalf of the shareholders.

Capital of a limited company

When a company issues a certain number of shares to its shareholders and they undertake to buy a certain number of registered shares, this is known as a **subscription**. As soon as the shareholders pay for their shares, the shares are liberalised. A distinction is made between **cash liberalisation** (payment into the company's bank account) and **non-cash liberalisation** (contribution of tangible assets). The booking can be processed via the shareholders' account, especially if the subscription and payment are made at different times. It is an auxiliary account for processing the formation or capital increase and belongs to the receivables. The capital is called share capital.
Registered shares do not have to be paid up in full. If only part of the shares are paid up, this is booked in the **Non-paid in share capital** account under capital assets.
Shares give shareholders the right to receive a share of the profit if they decide at the annual meeting to distribute it. This is called a dividend.
The shareholders can also decide to retain the profits and to put it in the reserves, which are also called legal retained earnings, for example if the profits are insufficient or the company needs to reinvest profits into the firm to enable it to grow. This will in turn increase the value of a share.

Loan capital of a limited company

If the limited company is listed at the stock exchange, the company is allowed to raise money not only through loans or mortgages, but also through debentures. **Debentures** are loan certificates.
Look at the following example: a company might issue CHF 1,000,000 2% debentures redeemable in 2034. That means that the debenture has to be repaid by 2034 and the debenture holders receive an annual interest of 2%.
The relative amount of loans to equity should be between 1:1 and a maximum of 2:1. Banks are usually not willing to grant higher loans.

Profit and dividends in the UK

What exactly happens with the profits? – The answer to this question has to be double as the UK and Switzerland handle this in completely different ways.
(We will not look at taxes on profits in this chapter.)

In the UK, the share capital can be as low as £1. All the net profit and the retained profits from the last year(s) can either be retained or partly or fully distributed. There is no legal regulation. Moreover, there is NO withholding tax (see following pages). The shareholders have to fill in the tax form and have to pay tax on dividends only if the amount of the total income is over £10,600. Only then, in the UK, they have to pay 25% of the dividends (or 30.56% if their income exceeds £150,000). This is according to legislation effective from 2013.

Profit and Dividends in Switzerland

In Switzerland, paying dividends is more complicated than in the UK.
The profits of the current year are added to the profits brought forward from the previous year. At the annual meeting, the supervisory board suggests how to distribute the profit. If the shareholders agree, the profits can be distributed and paid out.

According to OR 672, 5% of the annual profit must be retained and placed in the legal retained earnings. As soon as the **legal retained earnings** together with the **legal capital reserves** amount to at least 50% of the share capital, the allocation of profits becomes voluntary. Legal capital reserves are identical with the **agio**, i.e. any premium on the nominal value of a share. For the prosperity of the company, additional **voluntary retained earnings** can always be formed by resolution at the annual general meeting.
Profit shares paid to members of the board of directors are known as **royalties**. They are only allowed after the allocation to the legal retained earnings has been made and a dividend of 5% has been paid to the shareholders. In most cases, however, royalties are booked as an expense, as they are then tax-deductible.
If there is still money available afterwards, this becomes the new balance carried down in the profits brought forward account.
If there is a loss brought forward from the previous year, this must be eliminated before building retained earnings. According to OR 674, losses must be offset in the following order:

1. the profits brought forward
2. the voluntary retained earnings
3. the legal retained earnings
4. the legal capital reserves

Instead of steps 3 and 4, remaining losses could also be carried forward to the new annual financial statements.

Task 1

Blue Monkey AG increases its share capital from CHF 100,000 to CHF 200,000. Shareholder A contributes CHF 50,000 by bank transfer, shareholder B contributes his new car worth CHF 50,000.

Entries with account «shareholders»

→	**Subscription of share issues**	
→	**Shareholders / share capital**	**100,000**
→	**Payment of securities subscribed**	
→	**Bank / shareholders**	**50,000**
→	**Vehicles / shareholders**	**50,000**

Entries without account «shareholders»

→	**Bank / share capital**	**50,000**
→	**Vehicles / share capital**	**50,000**

Task 2

Blue Monkey AG has a share capital of CHF 100,000, legal retained earnings of CHF 5,000, no legal capital reserves and profits brought forward of CHF 800. The annual profit amounts to CHF 12,000, and the royalties amount to CHF 1,500. As many whole percents as possible should be distributed as dividends. Do the calculations.

Profits brought forward		**800**
Annual profit	+	**12,000**
Totally distributable		**12,800**
5 % Legal retained earnings on **12,000**	-	**600**
		12,200
5 % Dividends on **100,000**	-	**5,000**
		7,200
Royalties	-	**1,500**
		5,700
5% Dividends on 100,000	-	**5,000**
Profit to be brought forward		**700**

Task 3

Blue Monkey AG has a share capital of CHF 100,000, legal retained earnings of CHF 49,800, no legal capital reserves and profits brought forward of CHF 800. The annual profit amounts to CHF 12,000, royalties are CHF 1,500. As many whole percents as possible should be distributed as dividends. Do the calculations and write the entries down in the smallest number of entries possible.

Profits brought forward			800
Annual profit		+	12,000
Totally distributable			12,800
5 %	Legal retained earnings on **12,000 until it reaches 50,000**	-	**200**
			12,600
5 %	Dividends on **100,000**	-	**5,000**
			7,600
Royalties		-	1,500
			6,100
6%	Dividends on **100,000**	-	**6,000**
Profit to be brought forward			**100**

Entries

→	**End of the year (31/12/2024)**	
	Profit and loss account / Annual profit	**12,000**
	Annual profit / Closing balance	**12,000**
→	**New year (1/1/2025)**	
	Opening balance / profits brought forward	**12,800**
→	**New year after the annual meeting (within 6 months)**	
	Profits brought forward / legal retained reserves	**200**
	Profits brought forward / Dividend payouts resolved **(5,000+1500+6,000)**	**12,500**
	Dividend payouts resolved / Bank (65%)	**8,125**
	Dividend payouts resolved / Withholding tax owed (35%)	**4,375**
	Withholding tax owed / Bank	**4,375**

Task 4

Blue Monkey AG has a share capital of CHF 100,000, legal retained earnings of CHF 17,800, no legal capital reserves and losses brought forward of CHF 1,300. The annual profit is CHF 12,000. The royalties amount to CHF 1,500.
Do the calculations and write the entries down in the smallest number of entries possible.

Losses	brought forward	-	**1,300**
Annual profit		+	12'000
Totally distributable			**10,700**
5 %	legal retained earnings on **10,700 (!)**	-	**535**
			10,165
5 %	Dividends on **100,000**	-	**5,000**
			5,165
Royalties		-	1,500
			3,665
3 %	Dividends on **100,000**	-	**3,000**
Profit to be brought forward			**665**

Entries

→	**End of the year (31/12/2024)**	
	Profit and loss account / Annual profit	**12,000**
	Annual profit / Closing balance	**12,000**
→	**New year (1/1/2025)**	
	Losses brought forward / Opening balance	**1,300**
	Opening balance / Annual profit	**12,000**
	Annual profit / Profits brought forward	**12,000**
	Profits brought forward / Losses brought forward	**1,300**
→	**New year after the annual meeting (within 6 months)**	
	Profits brought forward / legal retained reserves	**200**
	Profits brought forward / Dividend payouts resolved (5,000+1500+3,000)	**9,500**
	Dividend payouts resolved / Bank (65%)	**6,175**
	Dividend payouts resolved / Withholding tax owed (35%)	**3,325**
	Withholding tax owed / Bank	**3,325**

Comment: Apparently there was a loss in previous years. It would therefore be better to distribute less in order to conserve liquidity.

Withholding Tax

At the annual meeting, the non-executive managers propose how to distribute the profits. As soon as the shareholders agree, the dividend can be paid. The company has (due to the Swiss law) to transfer 35% of the dividends (or on the interest from the debentures) to the government to make sure that the shareholders will declare the dividends on their tax record. 65% of the dividends can be transferred to the shareholders. If the shareholders fill out their Swiss tax declaration form, they will be taxed on their income and equity. They will be paid back the withholding tax, which is usually higher than the tax they have to pay on the dividends. (Foreigners can't declare in Switzerland, but if a double taxation agreement exists, the withholding tax can be reclaimed.)

Entries of the company

dividends / withholding tax owed 35%

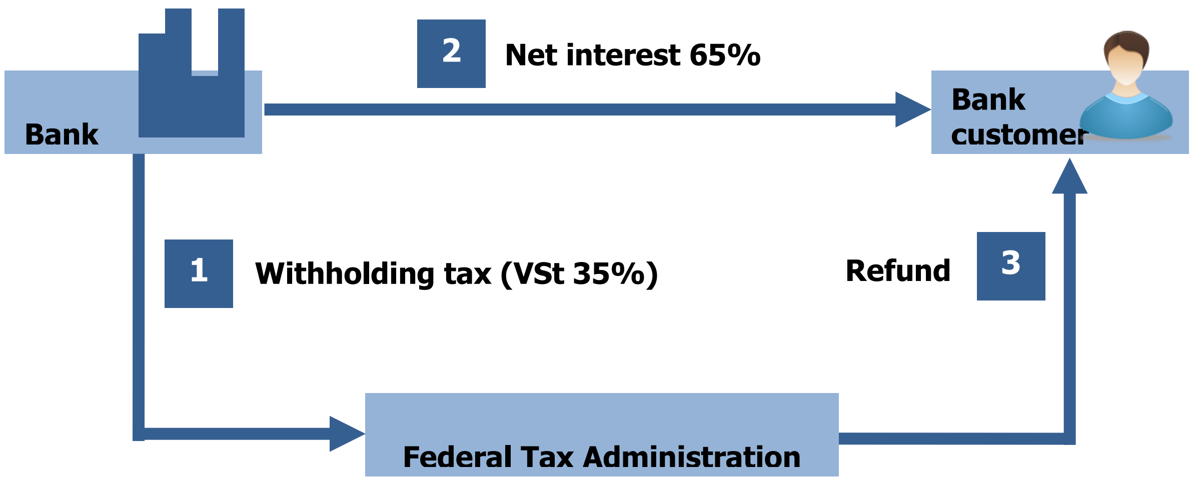
withholding tax owed / bank 35% (as soon as it is transferred)

dividends / bank 65%

1 Deduction withholding tax

2 Credit net interest

3 Refund



Task 5 – Key vocabulary

Please write the German expression on the line on the right.

public limited company, PLC	**Aktiengesellschaft, AG**
limited (company), Ltd.	**GmbH**
voting right	**Stimmrecht**
board of directors or supervisory board	**Verwaltungsrat, Aufsichtsrat**
CEO (Chief Executive Officer)	**Generaldirektor**
executive directors	**Direktoren, Geschäftsleitung**
authorized issued share capital	**(ausgegebenes) Aktienkapital**
debentures	**Obligationsanleihe**
shareholders	**Aktionäre (auch Kontenname)**
annual meeting	**Generalversammlung**
subscription	**Zeichnung (des Aktienkapitals)**
liberalisation	**Liberierung**
cash liberalisation	**Barliberierung**
non-cash liberalisation	**Sacheinlage**
non-paid-in share capital	**Nicht einbezahltes Aktienkapital**
agio	**Agio (=Aufpreis auf den Nennwert der Aktie)**
legal retained earnings	**gesetzliche Gewinnreserven**
voluntary retained earnings	**freiwillige Gewinnreserven**
dividend payouts resolved	**beschlossene Ausschüttungen**
royalty, royalties	**Tantieme, Tantiemen**
profits brought forward	**Gewinnvortrag**
annual profit	**Jahresgewinn / Reingewinn**
losses brought forward	**Verlustvortrag**
net interest	**Nettozins (65%)**
double taxation agreement	**Doppelbesteuerungsabkommen**

withholding tax (WT)	**Verrechnungssteuer (VSt)**
withholding tax owed	**geschuldete Verrechnungssteuer**
withholding tax receivable	**Guthaben Verrechnungssteuer**

Snakes and Ladders – Limited Companies

Instructions

Your teacher will give you a Snakes and Ladders game board plus your tokens and a die for each team.
Read the rules and play the game using the questions below.

Rules

Each player starts with a token in the starting square and takes turns to roll a single die to move the token by the number of spaces indicated by the die roll. If you hit the lower-numbered end of the spaces with a «ladder», you can move your token up to the higher-numbered space. If you hit the head of a «snake», you must move your token down to the tail end. A player who rolls a 6 with their die may, after moving, immediately take another turn; otherwise, the next player gets his or her turn. If a player rolls three 6s on the die, they return to square one. If you hit a square with a question mark, you have to answer a question. The space number indicates set of questions which the player on your left-hand-side has to read to you aloud. Start with the first question. If another player reaches the same square later on, you ask the next (new) question. All other players will decide whether your answer is correct or not. If your answer is right, you stay in your square. If your answer is wrong, you move three spaces back.
The winner is the player whose token first reaches paradise. If the roll of the die is too high, the token remains in place.

→<< See Teacher's Pack for the game board.>>

Questions

4 What are owners of a limited company called?
What is the difference between executive and non-executive directors?
Why is a financial statement very important for shareholders?
What is an annual audit?

6 What rights do shares carry?
What rules have to be followed in a limited company?
Who does the annual audit?
What does a shareholder receive if the company makes a profit?

8 What does a limited company do with its profits?
What does debenture mean?
What does mortgage mean?
What does loan mean?

10 Explain the word share capital.
Explain the word equity.
What is the difference between share capital and equity?
What different kinds of reserves exist in Switzerland?

12 What is the advantage of building reserves?
What is better for the shareholder: receiving dividends or building reserves? Explain.
What can be done if the company makes a loss in one year?
What does double taxation mean?

14 Does the UK have a withholding tax?
Does Switzerland have a withholding tax?
What is the advantage of a withholding tax for the government?
Does a resident in Switzerland lose money because of the withholding tax? Explain your answer.

16 What is the advantage of a listed limited company compared to a non-listed one?
What is the disadvantage of a listed limited company compared to a non-listed one?
What amount is the minimal share capital in the UK?
What amount is the minimal share capital in Switzerland?

18 What does the word dividend mean?
What does the word royalty mean?
What kinds of dividend exist in Switzerland?
What kind of account is the so called account «profits brought forward»?

20 What exactly can be distributed after a year?
What has to be retained before using the profit to pay dividends?
What fraction of the profit is the reserve?
Do you always have to build the first reserves? Explain.

22 What do the reserves need to be built on?
How long do reserves need to be built?
What is the entry for opening profits brought forward?
What is the entry for the current profit?

24 What is the entry for the reserve?
What is the entry for the dividend?
What is the entry for the royalties?
What is the entry for closing profits brought forward?

26 What is the entry for the subscription?
What is the entry for the cash liberalisation?
What is the entry for the non-cash liberalisation?
What percentage of dividends is the maximum allowed?

28 Which factors apart from the profit determine how much dividend can be paid?
Who decides how much dividend will be paid to the shareholders?
After having decided how much dividend will be paid, what are the entries the limited company has to make?
What are the entries the shareholder has to make?

30 What is withholding tax to be paid on?
Who remits the withholding tax to the government?
Does the government usually return the withholding tax to their taxpayers in cash?
What happens with the withholding tax collected from non-residents of Switzerland?

32 Compare sole proprietorships with limited companies concerning profits paid.
Compare sole proprietorships with limited companies concerning reserves.
Compare sole proprietorships with limited companies concerning royalties paid.
Compare sole proprietorships with limited companies concerning the closing balance sheet.

34 Compare sole proprietorships with public limited companies concerning withholding taxes.
Compare sole proprietorships with public limited companies concerning taxes in general.
Compare sole proprietorships with public limited companies concerning legal regulations.
Compare sole proprietorships with public limited companies concerning the annual audit.