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OWN SHARE PURCHASE - THE OPTIMUM SOLUTION?

Why should I contemplate a "Buy-Back"?

The three situations that commonly arise where a private company may find it beneficial to buy-back its own shares are:

- **Retirement or death of a Shareholder**
- **Breakdown in Shareholder Relationship**
- **Under Employee Share Incentive Schemes**

On the retirement or death of a shareholder, rather than the remaining shareholders acquiring the holding of the party concerned, it can be attractive for the Company to purchase the shares. The other shareholders may not wish to increase their investment in the Company, but be equally reluctant to contemplate the involvement of an "outside" third party in the business. In suitable cases, the purchase of own shares by the Company may provide the optimum solution, so enabling the outgoing party to liquidate his stake in the business. This solution can sometimes be found in a Company's Articles of Association or in Shareholder Agreements to cater for these situations.

Where there is a breakdown in the relationship between shareholders or disagreements on policy, often the only long term solution is to create an exit opportunity, so that the dissenting party can go his own way at the same time extracting a fair value for his shares. The remaining shareholders may not be willing or able to buy out the other party at that time using their own funds.

Under Employee Share Incentive Schemes an option for the company to re-purchase a party's shares on ceasing to be an employee is quite common.

Potentially Favourable Tax Treatment

Detailed tax advice should always be taken before contemplating any share transaction. Anti tax avoidance legislation creates a general rule that when a company purchases its own shares, then unless certain criteria are satisfied, the proceeds of sale will be treated as a "distribution" in the hands of the recipient and taxed as income.

Happily, where there is a genuine commercial purpose for the transaction, there are many a situations where it will be possible to satisfy the Inland Revenue tests, resulting in the sale proceeds being treated as a capital receipt. They will then be taxed under the Capital Gains Tax regime. This can be quite advantageous, because if Business Asset Taper Relief is available to the outgoing shareholder this usually results in a maximum tax liability of less then 10%.

There is also an established tax clearance procedure, so that the taxpayer can achieve certainty as to the tax treatment that will be applied by the Inland Revenue, with a ruling normally given within 28 days.

"Buy-Back" Procedure

Under Company Law there are certain requirements that must be satisfied for a Company own share purchase to be lawful.

To protect creditors, it is only exceptionally that a Company is permitted to reduce its share capital. Usually it is a requirement that there are “distributable profits” available equivalent to the price to be paid for the shares. The directors of the company are responsible for making the decision as to whether or not this is so and they will have regard to the latest statutory accounts as well as their knowledge of the current trading of the company derived from management accounts.

Alternatively, the price can be provided from the proceeds of a fresh issue of shares made specifically for the purpose of financing the share buy-back.

If all distributable profits are first exhausted, then it is also possible to finance the purchase from capital. The directors must make a statutory declaration confirming the solvency of the Company. The obligation should not be undertaken lightly, because if the Company becomes insolvent within one year then the directors could be personally liable. An auditor's report is also required, confirming that there are available and unused distributable profits and that the declaration made by the directors is not unreasonable.

Shareholder Approval

The Articles of the Company must provide for the Company to purchase its own shares. If no such power exists, then the Articles can be altered by Special Resolution, requiring a 75% majority vote and passed on 21 days notice. The contract must also be approved by shareholders holding three-quarters of the shares in the company (disregarding the votes of the outgoing shareholder). Where there is unanimous agreement between shareholders a Written Resolution can be used to avoid the need for a specially convened Extraordinary General Meeting of shareholders.

Payment

Payment in cash for the shares must be made at the time of completion of the buy-back, precluding deferred payment arrangements. But if cash payment is made in full upon completion, then the whole or part of the price can be loaned back to the company immediately afterwards.

Other Requirements

- The shares that are being purchased have to have been paid up in full.
- There must remain at least one shareholder in the Company after the buy-back.
- If pre-emption rights affect the shares that are being purchased, they must be waived.
- The Company must retain the Share Purchase Agreement for ten years at its registered office.

- The Registrar of Companies must be notified and Stamp Duty paid.

Need for Specific Advice

This note is intended as a general guide, and specific legal and taxation advice should always be sought before entering into any commitment or transaction. If you require any further information, please contact Simon Dakin on 0115 9 100 200 or email enquiries@actons.co.uk