

SHARE STRUCTURES

Purchase of Own Shares (Share Buy-Backs)

How a company buys its own shares: the funding rules, approvals, payment, filings, and where the tax treatment needs clearance.

When companies buy back shares

A company can buy its own shares, provided its articles do not prohibit it and the Companies Act 2006 is followed (s.690). Buy-backs are used to buy out a retiring or dissenting shareholder, to return surplus cash, to rearrange ownership without a third-party buyer, and on the death of a member. The seller gets cash and the company's remaining shares are cancelled, so the other members' holdings represent a larger share of the whole.

Where the money comes from

A private company can pay for the shares from several sources:

- **Distributable profits.** The usual route. The company needs sufficient distributable profits, shown by relevant accounts, and the directors should check them before the purchase.
- **Proceeds of a fresh issue of shares** made for the purpose.
- **Capital.** A private company can in some cases pay out of capital, in outline: the directors' statement of solvency, an auditor's report, a special resolution, and notice in the Gazette and to creditors. The payment is made between five and seven weeks after the resolution, and a member or creditor can object to the court within that time (ss.709 to 723).
- **Small purchases.** Subject to the articles and conditions, a private company may buy back up to a small annual amount out of capital without following the full procedure (s.692(1ZA)). The current limit should be checked.

A buy-back of this kind is not available where the company would be left with no shares other than redeemable shares (s.690(2)).

Approving the purchase

For an off-market purchase, which is the normal case for private companies, the terms of the contract must be approved by special resolution before the contract is made, or the contract must be conditional on that approval (ss.694 to 696). A copy of the contract, or a memorandum of its terms, must be available for members to inspect.

The member whose shares are to be bought cannot vote on the resolution if the resolution would not pass without their vote (s.695). The vote exclusion matters in a small company with few shareholders and should be planned for.

Key points

- Check the articles, which can restrict or authorise buy-backs.
- Use distributable profits unless the capital route is clearly justified.
- The contract must be approved by special resolution before it is made.
- The seller's own votes may not count.
- Payment must be made in full when the shares are bought. It cannot be deferred.
- The tax treatment can differ greatly depending on how the purchase is structured. Take advice and consider clearance.

Payment, filing and stamp duty

Shares must be paid for on purchase. The company cannot agree to pay later, except under limited rules about contracts (s.691).

After the purchase, the company files form **SH03**, return of purchase of own shares, within 28 days of the shares being delivered (s.707). Unless held in treasury, the shares are treated as cancelled when the purchase is completed (s.706), and the company files form **SH06** within one month of the cancellation (s.708) to notify the reduction in capital. The company must also update its register of members and, where the buy-back changes its capital, its statement of capital at the next confirmation statement.

Treasury shares are available to companies only where shares are qualifying shares, such as those listed or traded on a recognised market. For most private companies the shares are therefore cancelled. Where a company does hold treasury shares, other forms (SH04 and SH05) apply to their sale or cancellation.

Stamp duty is payable by the company on the purchase of its own shares at 0.5% of the consideration, rounded up to £5, where the consideration exceeds £1,000.

A buy-back from the estate of a deceased member is common, and the articles and any cross-option or insurance arrangements should be checked first, because they can affect the timing and the price.

Tax treatment: a pointer

The tax result for the seller can be treated as a capital disposal or as a distribution (dividend) depending on conditions in the tax legislation, including the seller's residence, shareholding and relationship with the company. HMRC offers a clearance procedure where the position is uncertain. These conditions are strict and technical, so the tax adviser should be involved before any agreement is signed, and clearance considered where the position is not clear.

Steps in a typical private company buy-back

1. Check the articles, distributable profits and any shareholders' agreement restrictions.
2. Agree the price and the terms with the seller.
3. Approve the contract by special resolution.
4. Complete the purchase and make the payment.
5. File SH03 within 28 days and SH06 within a month.
6. Account for stamp duty, and update the register and certificates.

Before agreeing terms

- Are there enough distributable profits?
- Do the articles allow it, and does anything in an investor agreement prevent it?
- Who is the seller, and can they vote?
- Will the price be paid in full on completion?
- Has the tax treatment been advised on?
- Is clearance worth requesting?
- Have the remaining shareholders been told?

How MTM can help

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We draft the purchase contract and resolutions, handle the approvals, file SH03 and SH06, work out the stamp duty with your client's accountants, and update the register and certificates. For practices, this can be delivered in your name. The distributable profits and tax analysis stay with your client's advisers.