

Purchase of own shares from reserves

In order to proceed with a purchase of own shares, the directors must ensure that there is nothing in either the Articles or any shareholders agreement that prevents the repurchase. If there is, then the Articles will require amendment. If the Articles include a pre-emption rights clause, then the company must pass written resolutions approving the purchase and disappling the pre-emption rights. The shares to be repurchased must be fully paid, and the repurchase must not result in there no longer being any member of the company holding shares other than redeemable shares or treasury shares. The company must make payment for the shares in cash and in full at completion.

Procedure for purchase of own shares

- 1 Under the Companies Act 2006, it is now possible to circulate a written resolution for the share purchase among those shareholders that would be entitled to vote at a general meeting, thus removing the requirement for an extraordinary general meeting. A majority of 75% is required to pass the resolution, i.e. a majority equivalent to that required to pass a special resolution. A member who holds shares to which the resolution relates is not eligible to vote.
- 2 A copy of the contract (if it is in writing) or a memorandum setting out its terms (if it is not) must be made available to members by being sent or submitted to every eligible member at or before the time at which the proposed resolution is sent or submitted to him. It must include the names of the members holding shares to which the contract/memorandum relates.
- 3 Once the company's members have approved the written resolution, a directors meeting is required to action the necessary steps to effect the share purchase. These are set out in points 4 to 10 below.
- 4 If the consideration exceeds £1,000, stamp duty is payable on the consideration at 0.5% (rounded up to the nearest multiple of £5).
- 5 Form SH03 ("Return of purchase of own shares") should be completed showing the number of shares purchased and the stamp duty payable (or certification if no stamp duty is payable). The company secretary should date the form the day that the company makes payment for the shares purchased.
- 6 Members should return share certificates to the company secretary before the secretary or a director signs form SH03.
- 7 If stamp duty is payable, form SH03 should be sent to: HMRC Stamp Office, 9th Floor, City Centre House, 30 Union Street, Birmingham B2 4AR, to be stamped together with a cheque made payable to 'HM Revenue & Customs Taxes' in respect of the stamp duty payable.
- 8 Once the Stamp Office have returned form SH03 (if applicable), it should be sent to Companies House for filing within 28 days of the date that the shares were repurchased.
- 9 When a company purchases its own shares, it cancels the shares on their return. Form SH06 ("Notice of cancellation of shares") should be completed showing the shares cancelled and an updated Statement of Capital reflecting the repurchase.
- 10 In the accounts, in order to maintain its capital base, a company creates a capital redemption reserve. The company makes a transfer from retained profits to this reserve equal to the nominal value of the shares repurchased.

Additional procedures in respect of a purchase of own shares out of capital

Subject to any restriction or prohibition in its articles, a private company can pass a special resolution to finance a purchase or redemption of shares out of capital. If a private company finances a purchase by a payment out of its capital, the directors must also make a statement about the solvency of the company immediately after the purchase and in the following year.

A payment out of capital for this purpose means a payment otherwise than out of available profits or out of the proceeds of a fresh issue of shares. If the company has some available profits and/or if the company chooses to make a fresh issue of shares for the purposes of the purchase, the payment out of capital will be only that part of the purchase price that remains after using up all such available profits and/or proceeds, known as the "permissible capital payment". Before the company makes such a payment, it must follow the additional procedures as set out below:

Additional procedures for a purchase of own shares out of capital

- 1 The directors calculate the available profits of the company (if any) by reference to accounts drawn up to a date within a period of three months, ending on the date of the directors' statement (as detailed below).
- 2 The directors make a statutory declaration regarding the solvency of the company. This is a statement that the directors have formed the opinion:
 - a. As regards its initial situation immediately following the date on which the payment out of capital is proposed to be made, that there will be no grounds on which the company could then be found unable to pay its debts, and
 - b. As regards its prospects for the year immediately following that date, that having regard to:
 - i. their intentions with respect to the management of the company's business during that year, and the amount and character of the financial resources that will in their view be available to the company during that year,
 - ii. The company will be able to continue to carry on business as a going concern (and will accordingly be able to pay its debts as they fall due) throughout that year.
- 3 In forming their opinion, the directors must take into account all of the company's liabilities (including any contingent or prospective liabilities).
- 4 The directors must then file the declaration at Companies House together with a report from the auditors stating that:
 - a. he has inquired into the company's state of affairs
 - b. the amount specified in the statement as the permissible capital payment for the shares in question is in his view properly determined in accordance with the Companies Act
 - c. he is not aware of anything to indicate that the opinion expressed by the directors in their statement is unreasonable in all the circumstances.
- 5 If the directors make their statement without having reasonable grounds for the opinion expressed in it, every director who is in default commits an offence and is liable upon conviction for a prison term not exceeding two years or a fine or both.
- 6 The directors must make a copy of the statement and auditors report available to the members at or before delivery of the written resolution.
- 7 The members must pass the written resolution on or within the week immediately following the date of the directors' statement.

- 8 Within a week of passing the written resolution, the company must make notice of the payment out of capital in the London Gazette stating the following:
 - a. that the company has approved a payment out of capital for the purpose of acquiring its own shares by redemption or purchase or both (as the case may be)
 - b. the amount of the permissible capital payment for the shares in question
 - c. the date of the resolution
 - d. where the directors' statement and auditor's report are available for inspection
 - e. that any creditor of the company may at any time within the five weeks immediately following the date of the resolution apply to the court for an order preventing the payment.
- 9 Within the same timeframe, the company must also make the same notice available in writing individually to all the company's creditors individually or publish the notice in a national newspaper.
- 10 Any creditor has five weeks from the passing of the resolution to apply to the court for the resolution to be cancelled.

Tax treatment of proceeds from sale by exiting shareholder

Advance clearance should be obtained under Section 225 ICTA 1988 for proceeds on shares purchased by the company to be treated as capital in the hands of the shareholder selling the shares. If the following conditions do not apply then it will be a deemed distribution (dividend).

- 1 The company must be UK resident and an unquoted trading company (or holding company of trading group).
- 2 The purchase must be to benefit the trade – i.e. because there is a dissenting shareholder, or as a result of the shareholder leaving, it will enable the remaining directors to proceed with the running of the company in the way they see fit.
- 3 The exiting shareholder must be resident and ordinarily resident in the UK.
- 4 The shares being acquired must be fully paid.
- 5 The exiting shareholder must have owned the shares for at least five years.
- 6 It must be a disposal of the entire holding or substantially reduce the shareholding. The exiting shareholder must not be connected with the company after the purchase, i.e. he/she must not control it directly or indirectly, possess more than 30% of the issued share capital, issued share and loan capital, voting rights or assets on a winding up.
- 7 The purchase price must be drawn out of the company's distributable profits or the purchase price may be up to the nominal value of the shares from a fresh issue of shares.

Where there are insufficient distributable profits, the company may (if certain procedures are followed) make a payment out of capital.