



Purchase By A Company Of Its Own Shares

This facility was introduced in 1982 providing a useful exit route for shareholders in private limited companies who otherwise would have no market for their shares.

When would a company wish to consider the purchase of its own shares?

- The death of a shareholder
- The retirement of an employee who holds shares in the company
- There is a disagreement over the management of the company and the dissident shareholder wishes to sell his shares.



Legal Requirements



The general rule as contained within the Companies Act 1985 is that any purchase of a company's own shares must be made out of the distributable profits of the company or out of the proceeds of a fresh issue of shares made for the purpose of the purchase.

Subject to stringent requirements a repurchase of shares out of capital reserves may be permissible. Such a capital payment may only be made after all distributable profits have been exhausted and is made by reference to "relevant accounts". The directors must also make a statutory declaration and the auditors will be required to report to the directors whether they feel a purchase out of capital is acceptable given the financial position of the company.

Financing

The purchase by a company of its own shares is unlikely to take place in isolation. The company may need to seek new finance in

order to fund the purchase as well as to ensure financial stability in the period following the purchase.

Future Distributions

If the remaining shareholders of the company continue to require dividend payments after the purchase of the shares then the availability of distributable reserves in the future will need to be considered.



How Should the Purchase Price be Determined?



The shareholder is likely to require a fair price in return for the company purchasing their shares. Monahans are able to provide specialist advice on the valuation of unquoted shares (see separate help sheet "Valuing Your Company's Shares").

Tax Treatment

There are two distinct methods of treating the purchase of a company's own shares for tax purposes; the "income distribution" route and the "capital distribution" route.

The income distribution route will apply unless specific conditions for the capital distribution route to apply are met.

Income Distribution Route

The individual from whom the shares are being purchased will be subject to Income Tax as if the amount in excess of the nominal value of the shares formed a dividend distribution.

The company will be treated for tax purposes as if it has paid a dividend.

Capital Distribution Route

Under this route the distribution is treated as capital proceeds in the hands of the shareholder leading to a capital gain that will be subject to capital gains tax at the standard rate of 18%/28% or at the reduced rate of 10%. This represents a significantly lower rate of tax than would apply to an income distribution.

The percentage shareholdings detailed above include shareholdings in the name of the vendor's spouse or minor children.

Although no claim is required if the following conditions are fulfilled, an advance clearance application is advisable:

- The company must be an unquoted trading company or the holding company of a trading group
- The purchase should take place for the benefit of the company's trade
- The purchase is not part of a scheme to avoid tax
- The vendor should be resident and ordinarily resident in the United Kingdom in the tax year of the purchase
- The shares must have been owned for at least 5 years before the date of the sale. (3 years if they were inherited)
- The vendor must not retain an interest of 30% or more in the issued share capital of the company
- The vendor's interest should be substantially reduced. The holding after the repurchase should not be more than 75% of the holding before the purchase.



Tax Planning

If both the company and the shareholder meet the conditions the capital route will apply.

Key attractions of the capital route include:

- Each individual has an individual capital gains exemption
- If the buy back is of shares in a trading company that the individual works for and owns more than 5% of, the standard rate of capital gains tax of 18%/28% may be reduced to 10% by the application of Entrepreneurs Relief on the first £10 million of gains arising.
- Since the introduction of Entrepreneurs Relief and the standard rate of capital gains tax being set at 18%/28%, there are very few occasions where it will be appropriate to try and fall outside capital treatment and subject the buy back to income tax as an income distribution due to the higher income tax rates that will apply (25%/36.2% from 6th April 2010).



Company Perspective



In most instances the company will be indifferent to which tax treatment is adopted. However, if there is still unrelieved Advanced Corporation Tax (ACT) within the company it is also important to take advice from Monahans to avoid the creation of "Shadow ACT".

For further advice and assistance

Our specialist Corporate Finance Department and tax advisers will be pleased to help.

Please contact **Peter Lugg** or **Dominic Bourquin** on **01225 472800**

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