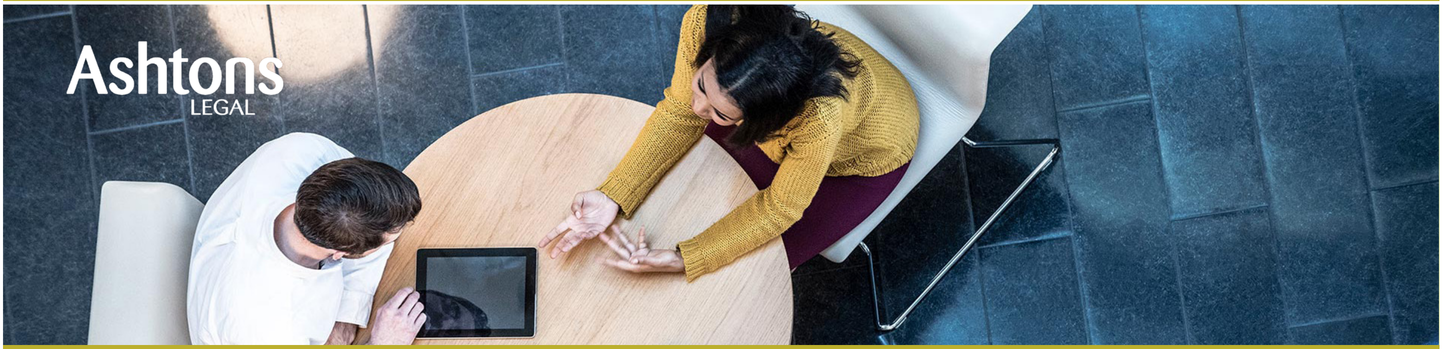

Company Own Share Purchase

A company own share purchase – also referred to as a share buyback – occurs when a limited company agrees to buy back shares from one of its shareholders, provided certain conditions set out in the Companies Act 2006 are met.

Why do an Own Share Purchase

Typically, a company may choose to buy back shares in order to, amongst other things:

1. Restructure its share capital, eg, to eliminate or reduce a class of shares or purchase redeemable shares in advance of their redemption date; or

2. Provide an exit route for shareholders, particularly if:

   a) There is a retiring director/shareholder or a deceased shareholder, as a share buyback may be the most straightforward way to remove them, especially if none of the existing shareholders are in a position to buy them out (or wish to do so); or

   b) A shareholder in a private company wishes to sell their shares and it is proposed that the company will buy them back, either pursuant to provisions in the company's articles of association or a shareholders' agreement, or where none of the existing shareholders are in a position to buy them out (or wish to do so).

Types of share buyback and financing

There are a number of different types of share buyback and a number of different ways in which a share buyback can be financed.

This Guide focuses on an "off-market" share buyback by a private limited company which is either to be financed out of its distributable profits or where the de minimis exemption applies.

This Guide is an overview of the process that needs to be followed and matters that need to be considered. It is not intended to be exhaustive.

Procedure

A share buyback requires various procedural steps to be taken. The majority of the work that is involved is ensuring that the transaction complies with the relevant section of the Companies Act 2006 so that the transaction is not declared invalid.w

Step 1

The first major consideration for the directors is how the own share purchase will be financed.

Out of Distributable Reserves

In order to perform a company own share purchase out of distributable reserves, the directors must first ensure that the company has distributable reserves of a value at least equal to the value of the consideration which is proposed to be paid to the exiting shareholder.

The company's accountant will need to assess whether the company has sufficient distributable reserves, by reference to the last filed annual accounts. If those last annual accounts do not show sufficient distributable reserves then a set of interim accounts may be prepared in order to justify the distribution.

If the company cannot be shown to have sufficient distributable reserves, the share buyback could be financed in other ways, but these are more complicated and outside of the scope of this Guide.

Having sufficient "distributable reserves" does not necessarily mean that the company has sufficient cash with which to purchase the shares. If the company does not have sufficient cash, it may be required to borrow money, typically from a bank, which would likely make the procedure more complicated depending on what the banks requirements are.

The De Minimis Exemption

A company may, in any financial year, perform own share purchases with an aggregate purchase price not exceeding the lower of £15,000 or the nominal value of 5% of its fully paid share capital as at the beginning of the financial year, provided that it is authorised to do so in its Articles of Association.

Most companies do not have this power in their Articles of Association, so the Articles of Association would need to be amended first in order to take advantage of this de minimis exemption.

Step 2 – The Articles of Association

The company will need to ensure that its articles of association do not exclude the authority of the company to buy back its own shares.

For companies incorporated under the provisions of the Companies Act 1948 this is an issue, but generally for more recent companies, i.e. those incorporated under the Companies Act 1985 onwards, this is not an issue.

The articles of association may also contain pre-emption provisions on the transfer of shares which would need to be followed or a list of "reserved maters" where a type of special consent maybe required.

Step 3 – Shareholders Agreement

As well as being mindful of any pre-emption provisions or reserved matters in the Articles of Association, the company will also need to identify whether there is a shareholders agreement which might similarly affect the sale of the shares back to the Company.

Step 4 – Written Contract

In order for a company to be able to purchase its own shares there must be a written contact between the company and the exiting shareholder setting out the terms of the buyback.

Under that contract, payment for the shares being sold to the company must be paid by the company in full on completion. You cannot have "deferred consideration".

It is however possible for shares to be bought back in a number 'tranches' (or instalments) whereby a set number of shares are bought back for a set amount of consideration in each tranche – this has the effect of performing a number of 'mini' company own share purchases that are all governed by the same purchase contract.

There are a number of additional considerations that need to be taken into account when doing an own share purchase in tranches, such as whether the unpurchased shares that will be left registered in the name of the exiting shareholder need to be converted into non-voting, non-dividend shares whilst they are waiting to be purchased.

Step 5 – Board Approval

Before seeking shareholder approval (Step 6), the directors will need to hold a board meeting in order to propose the company performing an own share purchase, approve the form of the purchase contract and approve the wording of the shareholders resolution to be circulated to the shareholders.

The accounts of the company or such other financial information which shows the financial position for the company should be tabled at the board meeting so that the directors can satisfy themselves that the company has sufficient distributable reserves (as set out in Step 1 above).

Step 6 – Shareholder Approval

It is the terms of the written contract between the company and the exiting shareholder which must be approved by a shareholder resolution - rather than the specific share buyback itself.

The terms of the contact need to be approved by more than 50% of the shareholders (excluding the exiting shareholder) unless the Articles of Association of the company require a higher majority.

This can either be done by a written resolution, which would need to be sent to all the shareholders (excluding the exiting shareholder) together with a copy of the proposed contract. Alternatively, approval can be obtained at an extraordinary general meeting of the shareholders, called on appropriate notice.

Step 7 – Completion

Only once shareholder approval has been obtained can own share purchase be completed.

As noted in Step 4, the consideration for the shares has to be paid in full on completion.

Step 8 – Post Completion

Once the transaction has completed, the appropriate level of stamp duty (at ½% of the consideration) must be paid to the HM Revenue and Customs by the company.

Companies House must be notified of the company own share purchase using the appropriate forms (the transfer of the shares pursuant to an own share purchase is not effected on a stock transfer form).

The shares are treated as cancelled and the company books must be updated accordingly. The company's PSC register may need to be updated.

A copy of the purchase contract is required to be kept with the company books for a period of at least 10 years.

What do I do now?

If you are a director of a company which is considering doing an own share purchase, or a shareholder whose shares are being proposed to be bought back by the company, then contact us for an initial no obligation discussion.

More information

To discuss how we can help you, please contact us:

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T: 01284 762331