1. INTRODUCTION

Private companies often decide to purchase their own shares from shareholders. A common situation is when an existing shareholder wants to sell some or all of his/her shares and the other shareholders are unwilling or unable to purchase them. This factsheet also provides an overview of a reduction of capital which involves no payments being made by the company to shareholders.

The legal, tax, accounting, reporting and general business planning issues need to be carefully considered. Ethical matters will also need to be considered by both accountants working in the business and external advisers if the accountant is advising both the company buying the shares and the shareholder selling the shares.

2. LEGAL ASPECTS

Companies Act 2006 sections 641 to 653 deal with reduction of share capital and Part 18 sections 658 to 737 deal with the purchase by a company of its own shares. A summary of these sections can be found in appendix 1.

The following legal requirements apply from 1 October 2009:

- A private company may redeem or purchase its shares out of capital by passing a special resolution together with a statement by each of the directors that the company is solvent supported by an auditors’ report as to the reasonableness of such a statement. See appendix 6 for an example of a special resolution.
- A private company may reduce its capital by issuing a solvency statement and passing a special resolution. This procedure does not require a report by the auditors.
- Public companies continue to require court approval for capital reduction.

Companies Act 1985 required private companies who wish to give financial assistance for the purchase of their own shares to comply with a ‘white-wash’ procedure. This requirement was abolished by the Companies Act 2006. From 1 October 2008 a private company can provide financial assistance for the purchase of its own shares, or shares of its private holding company, provided that it does not result in an unlawful reduction of capital.
However, Companies Act 2006 prohibits a public company from giving financial assistance directly or indirectly for the purpose of the acquisition of its shares or those of its holding company or for the purpose of reducing or discharging any liabilities incurred in the acquisition of such shares (CA2006 s678 & s679).

3. TAXATION

The shareholder selling the shares will be taxed on the sale of his/her shares to the company either based on the ‘distribution treatment’ or ‘capital treatment’. Distribution treatment is broadly the same as a dividend and subject to income tax whereas under the capital treatment the disposal is subject to capital gains tax.

Where certain conditions exist, CTA 2010 s1033 provides that the distribution treatment does not apply to a payment made by an unquoted company on redeeming or purchasing its own shares. The effect is that the vendor is treated as receiving a capital receipt. However, if the vendor is a share dealer, the receipt will be trading income.

CTA 2010 s1033 provides that the purchase consideration is exempt from distribution treatment under CTA 2010 s1000 if either:

1. the purchase is made wholly or mainly for the purpose of benefiting a trade, and certain other conditions are met (CTA 2010 s1033(2)(a)); or
2. the purchase is made to enable the vendor to pay inheritance tax (specific exemption in CTA 2010 s1033(3)).

Where the conditions in CTA 2010 s1033 are satisfied capital treatment is automatic. It cannot be ‘disclaimed’.

Nevertheless the vendor may be able to break one of the conditions to secure distribution treatment if this is beneficial.

HMRC will give clearance for capital treatment only if the purchase consideration is to be fully paid immediately on completion and paid in money. This means that payment by instalments is not possible. HMRC have indicated that it is possible to make a contract under which successive tranches of shares are to be purchased on specified dates (see Revenue Tax Bulletin issue 21, the link for which can be found below).

Under CTA 2010 s1044 a company proposing to make such a payment may ask HM Revenue and Customs to confirm either that CTA 2010 s1033 will apply, or that it will not apply. Further guidance on this clearance procedure can be found in SP2/82 the link for which can be found below. SP2/82 also gives guidance on the ‘trade benefit’ test referred to above. (SP2/82 has been reproduced in appendix 5).

If a company makes a purchase of own shares that it believes falls within CTA 2010 s1033, it must make a return of the transaction to the Inspector (CTA 2010 s1046). The return must:

(a) be made within 60 days of the payment
(b) give particulars of the payment
(c) explain why the company believes that CTA 2010 s1033 applies to the payment so as to exempt it from treatment as a distribution (see Statement of Practice SP2/82 (link below and appendix 5)).

The company must make such a return even if the Board has confirmed that CTA 2010 s1033 will apply to the payment.

If the company has agreed to pay the legal costs relating to a purchase of own shares such costs are generally disallowable in computing the company’s trading income. This is on the grounds that they are:

(i) capital expenditure in respect of the company’s share capital, or
(ii) within ICTA88 s74(1)(f).

The expenditure is also likely to fail the wholly and exclusively test under ICTA88 s74(1)(a). Company Taxation Manual CTM17320 contains information on the relevant law references concerning relief for costs of distributions and demergers, this can be found at http://www.hmrc.gov.uk/manuals/ctmanual/CTM17320.htm
HM Revenue & Customs has produced the following documents which have useful taxation information relating to company purchase of own shares:

1. Statement of Practice SP2/82 is reproduced in appendix 5 and can also be found at http://www.hmrc.gov.uk/agents/spop.pdf

HM Revenue and Customs issued guidance in Tax Bulletin 21 on purchase by an unquoted company of its own shares which is reproduced in appendix 6.

It is for the company and vendor shareholder to agree a price for the shares, however the directors have obligations to creditors and the shareholders. The following tax implications may arise if the company purchases its own shares for a value other than market value.

Purchase consideration exceeds market value

1. If HMRC can show that the purchase is not ‘a bargain made at arm’s length’ then they may seek to apply TCGA 1992, s17 which provides for market value to be substituted for the actual consideration. HMRC explain what they consider is ‘a bargain made at arm’s length’ in Capital Gains Manual CG14542 which can be found at http://www.hmrc.gov.uk/manuals/cgmanual/CG14542.htm
2. HMRC may argue that the excess of the consideration over market value is a distribution under ICTA 1988, s209(4).
3. HMRC may argue that the excess could fall within the definition of remuneration due to the wide scope of ICTA 1988, s19.

Purchase consideration less than market value

1. HMRC may argue that TCGA 1992, s17 should be applied (as explained above). This may result in a chargeable gain greater than the vendor expected. The excess is a gift to the company, although hold over relief under TCGA 1992, s165 is not available.
2. The gift will be a transfer of value for inheritance tax purposes, which will not be a potentially exempt transfer because it is a transfer to a company.
3. Business property relief may be available on the transfer of shares, although this would not apply if death occurred within seven years as the shares are cancelled on acquisition by the company and therefore cannot remain within the estate of the recipient.
4. A transfer at undervalue followed by some remaining connection with the company may result in the ‘reservation of benefit’ provisions being relevant and the estate on subsequent death could be treated as including the gifted element.

4. ACCOUNTING

CA 2006 s686 only allows redeemable shares to be redeemed if they are fully paid. Similarly s691 only allows a limited company to purchase its own shares if they are fully paid.

Private companies, and public companies with shares which are not listed or traded on one of the markets highlighted below, will continue to be required to cancel any of their shares they purchase.

Treasury Shares
The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (SI 2003 No 116) amended the Companies Act 1985 so that in certain circumstances qualifying shares may be held ‘in treasury’ for future sale by the company. If the conditions are not met then the company must cancel the shares when they purchase them.

Only ‘qualifying shares’ may be held as treasury shares. Such shares need to satisfy at least one of the conditions specified in CA 2006 s724(2) which are:

1. Included in the official list; or
2. Traded on the Alternative Investment Market; or
3. Officially listed in another EEA State; or
Traded on a market established in an EEA State which is a regulated market for the purposes of article 16 of Council Directive 93/22 EEC on investment services in the securities field.

Companies Act 2006 sections 724 to 732 deals with treasury shares.

**Capital Redemption Reserve**

Where shares are redeemed or purchased wholly out of profits available for distribution a sum equal to the amount by which the company’s share capital is diminished on cancellation of the shares (there nominal value of the shares) should be transferred to the capital redemption reserve (CRR). (CA 2006 s733)

Where the redemption or purchase is financed wholly or partly by a new issue of shares, the transfer to the CRR is reduced by the proceeds of the new issue. In the case of a private company the transfer to the CRR should be further reduced to the extent that the company can make a permissible capital payment.

The capital redemption reserve may only be used subsequently to make a bonus issue of shares.

**Worked Example 1**

**Simple buy back at par value.**

A company has the following balance sheet:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>25,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>15,000</td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>25,000</strong></td>
</tr>
</tbody>
</table>

A decision is made to buy back 3,750 ordinary £1 shares at par.

The entries would be as follows:

\[
\begin{align*}
\text{DR} & \quad \text{CR} \\
\text{Ordinary share capital} & \quad 3,750 \\
\text{Bank account} & \quad 3,750 \\
\text{To redeem the shares} & \quad \text{Profit and loss account reserve} 3,750 \\
& \quad \text{Capital redemption reserve} 3,750 \\
& \quad \text{To maintain the capital at its original amount} \end{align*}
\]

The balance sheet will now be:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>21,250</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>11,250</td>
</tr>
<tr>
<td>Capital redemption reserve</td>
<td>3,750</td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>6,250</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21,250</strong></td>
</tr>
</tbody>
</table>

If there had been a fresh issue of shares, the second journal to maintain the capital would not have been necessary, except to the extent that the fresh issue fell short of £3,750.
**Worked Example 2**  
**Redemption at a premium**

If the above transaction had not been at par, but was instead at a premium of 20p per share, the entries would be as follows:

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ordinary share capital</strong></td>
<td>£3,750</td>
</tr>
<tr>
<td><strong>Profit and loss reserve</strong></td>
<td>£750</td>
</tr>
<tr>
<td><strong>Bank account</strong></td>
<td>£4,500</td>
</tr>
<tr>
<td><strong>To redeem the shares</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Profit and loss reserve</strong></td>
<td>£3,750</td>
</tr>
<tr>
<td><strong>Capital redemption reserve</strong></td>
<td>£3,750</td>
</tr>
<tr>
<td><strong>To maintain the capital at its original amount</strong></td>
<td></td>
</tr>
</tbody>
</table>

The balance sheet will now be:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash at bank</strong></td>
<td>20,500</td>
</tr>
<tr>
<td><strong>Ordinary £1 shares</strong></td>
<td>11,250</td>
</tr>
<tr>
<td><strong>Capital redemption reserve</strong></td>
<td>3,750</td>
</tr>
<tr>
<td><strong>Profit and loss account</strong></td>
<td>5,500</td>
</tr>
<tr>
<td></td>
<td>20,500</td>
</tr>
</tbody>
</table>
Worked Example 3
Redemption at a premium and shares issued at a premium

A company has the following balance sheet:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>28,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>10,000</td>
</tr>
<tr>
<td>Redeemable preference £1 shares</td>
<td>4,000</td>
</tr>
<tr>
<td>Share premium account</td>
<td>1,800</td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>12,200</td>
</tr>
</tbody>
</table>

The decision was made to redeem all the preference shares with a redemption premium of 25p per share. The preference shares were originally issued at a premium of 20p per share. The company also plans to make a fresh issue of 2,000 ordinary £1 shares at £1.50 per share.

The entries would be as follows:

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>3,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>2,000</td>
</tr>
<tr>
<td>Share premium account</td>
<td>1,000</td>
</tr>
<tr>
<td>To record the new issue</td>
<td></td>
</tr>
<tr>
<td>Redeemable preference shares</td>
<td>4,000</td>
</tr>
<tr>
<td>Share premium account</td>
<td>800</td>
</tr>
<tr>
<td>Profit and loss reserve</td>
<td>200</td>
</tr>
<tr>
<td>Cash</td>
<td>5,000</td>
</tr>
<tr>
<td>To redeem the redeemable preference shares</td>
<td></td>
</tr>
<tr>
<td>Profit and loss reserve</td>
<td>1,800</td>
</tr>
<tr>
<td>Capital redemption reserve</td>
<td>1,800</td>
</tr>
<tr>
<td>To maintain the capital</td>
<td></td>
</tr>
</tbody>
</table>

The balance sheet would now be:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>26,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>12,000</td>
</tr>
<tr>
<td>Share premium account</td>
<td>2,000</td>
</tr>
<tr>
<td>Capital redemption reserve</td>
<td>1,800</td>
</tr>
<tr>
<td>Profit and loss reserve</td>
<td>10,200</td>
</tr>
</tbody>
</table>

The amount of the share premium on the new issue, as restricted by the amount included in the share premium account from the original issue of the redeemable shares, can be released to set against the premium payable on redemption, thus reducing the amount to be debited to distributable reserves. The amount of the adjustment required to maintain capital is the amount that the proceeds of the new issue fell short of the nominal value of the shares redeemed, as adjusted for the amount already applied towards the redemption (£4,000-£3,000+£800).

Share Premium Account
Where the shares to be redeemed or purchased were issued at a premium and a fresh issue of shares is made for the purposes of the redemption or purchase, any premium payable on redemption or purchase may be charged against the share premium account. The premium so charged cannot exceed the lower of:
(a) the premium received on the issue of the shares now being redeemed or purchased
(b) the current balance of the share premium account, including any premium on the new share issue
(c) the proceeds of the fresh issue.

Therefore where there is no fresh issue of shares no amount may be charged to the share premium account.

**Worked Example 4**

**Issue of new shares and redemption**

A private company has the following balance sheet:

\[
\begin{array}{ll}
\text{Cash at bank} & £3,500 \\
\text{Ordinary £1 shares} & 2,000 \\
\text{Share premium account} & 0 \\
\text{Profit and loss account} & 1,500 \\
\end{array}
\]

The decision is made to buy back 300 ordinary £1 shares for £2.00 each (£600 in total) which were originally issued for £1.50 each (£450 in total). The company is to issue 1,000 new ordinary £1 shares for £1.20 each (£1,200 in total). The share premium account which arose on the original issue of the shares now being redeemed or bought back was used some time ago to fund a bonus issue of shares. The journal entries for the new issue and buy back would be as follows:

\[
\begin{array}{ll}
\text{DR} & \text{CR} \\
\text{Share capital} & 1,000 \\
\text{Share premium account} & 200 \\
\text{Cash at bank} & 1,200 \\
\end{array}
\]

\[
\begin{array}{ll}
\text{To effect the new issue} \\
\text{Cash at bank} & 600 \\
\end{array}
\]

\[
\begin{array}{ll}
\text{Share capital} & 300 \\
\text{Share premium account} & 200 \\
\text{Profit and Loss Reserve} & 100 \\
\text{Cash at bank} & 600 \\
\end{array}
\]

\[
\begin{array}{ll}
\text{To effect the buy back of shares} \\
\text{Cash at bank} & 4,100 \\
\end{array}
\]

Afterwards the balance sheet will look like this:

\[
\begin{array}{ll}
\text{Cash at bank} & £4,100 \\
\text{Ordinary £1 shares} & 2,700 \\
\text{Profit and loss account} & 1,400 \\
\end{array}
\]

**Permissible Capital Payments (only applicable to private companies)**

The Permissible Capital Payment (PCP) is the amount by which the purchase or redemption cost exceeds the amount of distributable profits plus the proceeds of any new share issue.

If the PCP is less than the nominal value of the shares redeemed or purchased, the difference is transferred to Capital Redemption Reserve (CA2006 s734(2)). This means that a private company should use its available profits and any share proceeds before making a payment out of capital.

If the PCP is more than the nominal value of the shares redeemed or purchased, the excess may be used to reduce any of the following:
(a) capital redemption reserve  
(b) share premium account  
(c) revaluation reserve  
(d) fully paid share capital (CA2006 s734(3))

**Worked Example 5**  
**Redemption when insufficient reserves**

A private company has the following balance sheet:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>15,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>14,000</td>
</tr>
<tr>
<td>Profit and Loss Reserve</td>
<td>1,000</td>
</tr>
</tbody>
</table>

The decision is made to buy back 7,000 ordinary £1 shares at par. The distributable reserves are insufficient to allow this without a permissible capital payment. The procedures set out in the Companies Act have to be followed, and then the journal entries would be as follows:

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>7,000</td>
<td></td>
</tr>
<tr>
<td>Cash at bank</td>
<td>7,000</td>
<td></td>
</tr>
<tr>
<td>To effect the redemption</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit and Loss Reserve</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Capital Redemption Reserve</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>To maintain the capital as far as possible</td>
<td></td>
<td>1,000</td>
</tr>
</tbody>
</table>

Afterwards the balance sheet will look like this:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>8,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>7,000</td>
</tr>
<tr>
<td>Capital Redemption Reserve</td>
<td>1,000</td>
</tr>
</tbody>
</table>

In worked examples 1 to 3 above the share capital and undistributable reserves total to the same amount after the buy back as they did before, which is due to there being sufficient reserves to maintain the capital by virtue of a capital redemption reserve. In worked example 5 the total has reduced by £6,000 from £14,000 to £8,000. This £6,000 is the amount of the permissible capital payment which is equal to the shortfall on the profit and loss account reserves before the redemption.
Worked Example 6  
Permissible capital payments (no new issue of shares)

A private company has the following balance sheet:

\[
\begin{align*}
\text{Cash at bank} & \quad \pounds 13,000 \\
\text{Ordinary £1 shares} & \quad \pounds 14,000 \\
\text{Profit and loss account} & \quad (\pounds 1,000) \\
\end{align*}
\]

The decision is made to buy back 7,000 ordinary £1 shares for £0.50 each (£3,500 in total) which were originally issued at par. The company has no distributable profits.

The relevant calculations are as follows:

\[
\begin{align*}
\text{Cost of purchase} & \quad \pounds 3,500 \\
\text{Less: distributable profits} & \quad \text{nil} \\
\text{Less: proceeds of fresh issue} & \quad \text{nil} \\
\text{Permissible capital payment} & \quad \pounds 3,500 \\
\end{align*}
\]

\[
\begin{align*}
\text{Nominal value of purchase} & \quad 7,000 \\
\text{Less: proceeds of fresh issue} & \quad \text{nil} \\
\text{Less: permissible capital payment} & \quad \pounds 3,500 \\
\text{Transfer to capital redemption reserve} & \quad \pounds 3,500 \\
\end{align*}
\]

The journal entries for the buy back would be as follows:

<table>
<thead>
<tr>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>7,000</td>
</tr>
<tr>
<td>Capital redemption reserve</td>
<td>3,500</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>3,500</td>
</tr>
</tbody>
</table>

Afterwards the balance sheet will look like this:

\[
\begin{align*}
\text{Cash at bank} & \quad \pounds 9,500 \\
\text{Ordinary £1 shares} & \quad \pounds 7,000 \\
\text{Capital redemption reserve} & \quad \pounds 3,500 \\
\text{Profit and loss account} & \quad (\pounds 1,000) \\
\end{align*}
\]

\[
\begin{align*}
\text{9,500} \\
\text{7,000} \\
\text{3,500} \\
\text{(1,000)} \\
\text{9,500} \\
\end{align*}
\]
Worked Example 7
Permissible capital payments (with new issue of shares)

A private company has the following balance sheet:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>18,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>10,000</td>
</tr>
<tr>
<td>Share premium account</td>
<td>5,000</td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>3,000</td>
</tr>
</tbody>
</table>

The decision is made to buy back 5,000 ordinary £1 shares for £1.40 each (£7,000 in total) which were originally issued at par. The company is to issue 1,000 new ordinary £1 shares for £3.50 each (£3,500 in total).

The relevant calculations are as follows:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of purchase</td>
<td>7,000</td>
</tr>
<tr>
<td>Less: distributable profits</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Less: proceeds of fresh issue</td>
<td>(3,500)</td>
</tr>
<tr>
<td>Permissible capital payment</td>
<td>500</td>
</tr>
</tbody>
</table>

Nominal value of purchase
<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: proceeds of fresh issue</td>
<td>(3,500)</td>
</tr>
<tr>
<td>Less: permissible capital payment</td>
<td>(500)</td>
</tr>
<tr>
<td>Transfer to capital redemption reserve</td>
<td>1,000</td>
</tr>
</tbody>
</table>

The journal entries for the new issue and buy back would be as follows:

<table>
<thead>
<tr>
<th></th>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Share premium account</td>
<td></td>
<td>2,500</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>3,500</td>
<td></td>
</tr>
<tr>
<td>To effect the new issue</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>DR</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>Cash at bank</td>
<td>7,000</td>
<td></td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Capital redemption reserve</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>To effect the buy back of shares</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Afterwards the balance sheet will look like this:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>14,500</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>6,000</td>
</tr>
<tr>
<td>Share premium account</td>
<td>7,500</td>
</tr>
<tr>
<td>Capital redemption reserve</td>
<td>1,000</td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>nil</td>
</tr>
</tbody>
</table>

The following procedures must be followed before a payment out of capital can be lawfully made:

1. The payment must be approved by a special resolution (CA 2006 s716(1))
2. The directors must make a statement (CA 2006 s714(1-3))
3. A report by the company’s auditors must be annexed to the directors’ statement (CA 2006 s714(6))
4. Within a week of the date of the special resolution a notice of the proposed capital payment, giving the information specified in CA 2006 s719 must be published in the Gazette and
5. Within a week of the date of the special resolution a notice of the proposed capital payment, giving the information specified in CA 2006 s719 must be published in a national newspaper or given by written notice to each creditor.

The director’s s714 statement is explained in greater detail:

The directors’ statement under CA2006 s714(1-3) the directors are required to issue a statement that must specify the amount of the permissible capital payment for the shares in question and that, in their opinion as regards its initial situation following the date on which the payment out of capital is proposed that there will be no grounds on which the company could then be found unable to pay its debts and for the following year 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). In forming their opinion the directors must take into account all of the company’s liabilities (including any contingent or prospective liabilities).

The directors’ statement must be in the prescribed form and must have annexed to it a report by the auditors’ stating that he has inquired into the company’s state of affairs, that the permissible capital payment for the shares in question has been properly determined and that he is not aware of anything to indicate that the opinion expressed by the directors as to the ability of the company to pay its debts and continue as a going concern is unreasonable.

Reduction of Capital (by special resolution and solvency statement is only available to private companies)

This reduction generally applies:
- Where the company wishes to reduce the liability on any of its shares in respect of share capital not paid up;
- Where the company is over-capitalised;
- Where the company has suffered a loss of capital (i.e. cancelling share capital which is unrepresented by available assets).
Worked Example 8
Reduction of capital

A private company has the following balance sheet:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>18,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>10,000</td>
</tr>
<tr>
<td>Share premium account</td>
<td>5,000</td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>3,000</td>
</tr>
</tbody>
</table>

The share premium account arose when the ordinary shares were issued for £1.50 each. The decision is made to reduce the ordinary shares by £8,000 and to reduce the share premium account by £4,000 because the company is over capitalised. The proper procedure needs to be followed and then the journal entries would be as follows:

```
DR   CR
£    £
Ordinary £1 shares       8,000
Share premium account    4,000
Profit and loss account  12,000
```

Afterwards the balance sheet will look like this:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at bank</td>
<td>18,000</td>
</tr>
<tr>
<td>Ordinary £1 shares</td>
<td>2,000</td>
</tr>
<tr>
<td>Share premium account</td>
<td>1,000</td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>15,000</td>
</tr>
</tbody>
</table>

From 1 October 2008 a new means by which a private company can reduce its share capital was introduced by CA 2006 s641 and statutory instrument ‘The Companies (Reduction of Share Capital) Order 2008’ (SI 2008/1915) sets out the means by which a company can reduce its share capital. This procedure also applies to a reduction in those reserves which have similar characteristics to share capital (ie the share premium account and the capital redemption reserve) although it does not apply to any merger reserves. For private companies court approval is not required neither is an auditors’ report required.

CA 2006 s641(2) states that this method of capital reduction cannot be used if after the reduction there would no longer be any member of the company holding shares other than redeemable shares or if the articles do not permit it.

This procedure is that directors make a solvency statement confirming that each director:

1. Has formed the opinion, as regards the company’s situation at the date of the statement, that there is no ground on which the company could then be found to be unable to pay (or otherwise discharge) its debts; and
2. Has also formed the opinion
   (a) if it is intended to commence the winding up of the company within twelve months of that date, that the company will be able to pay (or otherwise discharge) its debts in full within twelve months of the commencement of the winding up; or
   (b) in any other case, that the company will be able to pay (or otherwise discharge) its debts as they fall due during the year immediately following that date.

The statement must:

1. be in writing;
2. indicate that it is a solvency statement for the purposes of CA2006 s642;
3. state the date on which it is made;
4. name each of the directors of the company;
5. be signed by each of the directors.
The shareholders must pass a special resolution reducing the share capital no later than 15 days after the directors have made the solvency statement.

No later than 15 days after the shareholders have passed the special resolution, the company must file with the Registrar of Companies:

1. The solvency statement
2. The special resolution
3. A statement of capital setting out the details of the share capital as reduced
4. A statement by the directors confirming that the solvency statement was made not more than 15 days before the date on which the special resolution was passed and that it was provided to members in accordance with the requirements of the Act.

The resolution takes effect on registration by the registrar. Creditors have no right to object to a reduction of capital supported by a solvency statement. Statutory Instrument 2008/1915 states that a credit to reserves arising from a reduction or cancellation of capital supported by a solvency statement is a realised profit.

5. REPORTING

The company's articles and memorandum of association will need to be reviewed to ensure the company is not prohibited from purchasing its own shares. The company's articles and memorandum have to be complied with, in addition to the statutory requirements. ‘Unaltered’ articles drawn up using the Companies Act 2006 will allow redemption, however ‘altered’ articles or articles drawn up using Companies Act 1985 will need to be reviewed to ensure that the company has the right to purchase its own shares.

The following conditions need to be met and documents and returns are required if a company purchases its own shares:

1. Return under CTA 2010 s1046 to be sent to HMRC as explained in taxation section 3 above.
2. The directors of a limited company (public or private company) may determine the terms, conditions and manner of redemption of shares if they are authorised to do so by the company articles or by an ordinary resolution of the company (CA 2006 s685).
3. If a limited company redeems any redeemable shares it must within one month after doing so give notice to the registrar, specifying the shares redeemed. The notice must be accompanied by a statement of capital giving details specified in CA 2006 s689.
4. Depending on the type of company and authorisation (see 2 above) a company will either require a special resolution to approve an off-market purchase (CA 2006 s694) (a copy of the contract must be made available to members and comply with CA 2006 s696), or an ordinary resolution to authorise a market purchase (CA 2006 s701).

In both cases the resolution must be sent to the Registrar of Companies within 15 days (CA 2006 s30).

In general, market purchases are limited to listed shares and those traded on the AIM.

5. Any contract for purchase of own shares must be retained at the company's registered office for a period of ten years and be open to inspection without charge to any member of the company and for public companies by any other person (CA 2006 s702).
6. The Registrar of Companies must be notified within 28 days of the purchase of own shares (CA 2006 s707). The return must distinguish between treasury shares and other shares and between treasury shares which are cancelled and not cancelled.
7. The company must give notice of cancellation of shares to the registrar within 28 days specifying the shares cancelled and accompanied by a statement of capital complying with CA 2006 s708.
8. A private company may make a payment, for purchase of own shares, out of capital (CA 2006 s709). The company's directors must make a statutory declaration CA2006 s714 (specifying the amount of the permissible capital payment and confirming that the company can pay its debts as they fall due for at least one
year). The declaration must have attached to it a report by the company’s auditors addressed to the directors (see appendix 2).

9. If a company wants to make a payment out of capital for purchase of own shares a special resolution (to be passed within one week of the directors’ statement under section 714) is required under CA 2006 s716. The resolution is ineffective unless the statutory declaration and auditors’ report required by the section are available for inspection by members of the company at the meeting at which the resolution is passed. A special resolution of the members (or of a class of members) of a company means a resolution passed by a majority of not less than 75% after giving notice as specified in subsection 6 of section 283 (CA 2006 s283).

10. Within the week immediately following the date of the resolution for payment out of capital, the company must publish details prescribed by CA 2006 s719 in the Gazette and either an appropriate national newspaper or inform each creditor.

11. The company must deliver to the Registrar of Companies a copy of the director's statutory declaration and the auditors’ report. These documents must also be available for inspection by members and creditors at the company’s registered office (CA 2006 s720).

12. Where a private company passes a special resolution approving a payment for purchase of own shares out of capital. Creditors and members can apply to the court for cancellation of the resolution. If an application is made, the company shall give notice and send a copy of the court order to the Registrar of Companies (CA 2006 s722).

Forms to be filed at Companies House can be found at the following address: http://www.companies-house.gov.uk/forms/formsOnline.shtml

The following forms relate to purchase of own shares:

- SH03 Return of purchase of own shares.
- SH06 Notice of cancellation of shares.
- SH16 Notice by the applicants of application to court for cancellation of the special resolution approving a redemption or purchase of shares out of capital.
- SH17 Notice by the company of application to court for cancellation of the special resolution approving a redemption or purchase of shares out of capital.

6. GENERAL BUSINESS PLANNING ISSUES

When a company purchases its own shares from a shareholder there are at least two business planning issues to bear in mind, which are:

The company will be paying for the shares. This will usually be in money from the bank account, however, it may be in the form of assets. ACCA have a section of the website looking at business finance that specifically deals with ‘types of finance’, ‘the right finance for your business’, ‘business plans’ and ‘applying for finance’. This can be found at the following address: http://www.accaglobal.com/en/business-finance.html

1. The shareholder who is selling his/her shares to the company may be a director and/or employee in the company. When the shares are sold to the company the ex-shareholder may also cease working for the company, taking away skills and experience and possibly business contacts.

If the intention is for the company to continue then it should ensure that it can survive both of these events and thrive in the future. The intention may be for the company to cease trading and possibly to be wound up in which case purchase of its own shares or reduction of capital may be a preliminary step before that process occurs.

7. ETHICAL CONSIDERATIONS FOR THE ADVISER, BOTH INTERNAL AND EXTERNAL

Ethical matters will need to be considered if the accountant (internal or external) is advising both the company buying the shares and the shareholder selling the shares. The company will usually try to achieve as low a price as possible for the shares whereas the shareholder will try to achieve as high a price as possible. This may lead to a conflict between the interests of the different parties particularly when the adviser is involved in the share valuation. The ACCA Rulebook gives guidance on this which for 2012 is in section 220 pages 307 to 310 ‘Conflicts of Interest’. In particular safeguards can usually be implemented to overcome these conflicts such as notifying all known relevant parties that the
professional accountant in public practice is acting for two or more parties in respect of a matter where their respective interests are in conflict and obtaining their consent to so act.

The ACCA Rulebook 2012 can be found at the following address:
Appendix 1

Summary of the Law relating to Company’s Buy Back of Own Shares

The Companies Act 2006 has a section dealing with the acquisition by a company of its own shares which is in Part 18 sections 658 to 737, these sections were implemented on 1 October 2009. The Companies Act 2006 can be found at the following address:  

Companies Act 2006

‘Reduction of capital’ is dealt with in sections 641 to 653 of the Companies Act 2006.

‘Purchase of own shares’ is dealt with in sections 690 to 708 of the Companies Act 2006. Sections 709 to 723 deal with ‘redemption or purchase by private company out of capital’. The main points in these sections are summarised below.

S690
A limited company having a share capital may purchase its own shares if not prohibited by the company’s articles unless if after the purchase there would no longer be any issued shares of the company other than redeemable shares or shares held as treasury shares.

S691
A limited company may not purchase its own shares unless they are fully paid and where a limited company purchases its own shares, the shares must be paid for on purchase.

S692
1. A private limited company may purchase its own shares out of capital in accordance with sections 709 to 723.
2. Subject to that
   (a) a limited company may only purchase its own shares out of:
      i. distributable profits of the company, or
      ii. the proceeds of a fresh issue of shares made for the purpose of financing the purchase, and
   (b) any premium payable on the purchase by a limited company of its own shares must be paid out of distributable profits of the company, subject to subsection (3).
3. Shares to be purchased were issued at a premium; any premium payable on their purchase by the company may be paid out of the proceeds of a fresh issue of shares made for the purpose of financing the purchase, up to an amount equal to:
   (a) the aggregate of the premiums received by the company on the issue of the shares purchased, or
   (b) the current amount of the company’s share premium account (including any sum transferred to that account in respect of premiums on the new shares), whichever is the less.
4. Amount of the company’s share premium account is reduced by the sum corresponding (or by sums in the aggregate corresponding) to the amount of any payment made under subsection (3) above.

Under section 735 if the company is wound up and at the commencement of the winding up, the company either:
   (c) has issued shares on terms that they are or are liable to be redeemed, or
   (d) has agreed to purchase any of its shares.
Then, if any of those shares in (a) or (b) above have not been redeemed or purchased, the terms of redemption or purchase may be enforced against the company.

S693
A limited company may only purchase its own shares-
(a) by an off-market purchase, in pursuance of a contract approved in advance in accordance with section 694;
(b) by a market purchase, authorised in accordance with section 701.
A purchase is a ‘market purchase’ if it is made on a recognised investment exchange.

$694
A company may only make an off-market purchase of its own shares in pursuance of a contract approved prior to the purchase in accordance with this section.
Either
(a) the terms of the contract must be authorised by a special resolution of the company before the contract is entered into, or
(b) the contract must provide that no shares may be purchased in pursuance of the contract until its terms have been authorised by a special resolution of the company.
Subsections (3) to (6) contain provisions relating to off-market purchase.
Sections 695 to 700 also relate to ‘off-market purchase’ and explain the resolutions required and disclosure of information to members.
Section 701 relates to ‘authority for market purchase’ as referred to in section 693.
Sections 702 and 703 relate to rights to inspect copy of contract (for off-market purchase or market purchase) or memorandum setting out the contract terms.
Section 704
The rights of a company under a contract authorised under section 694 or 701 are not capable of being assigned.
Section 705 refers to acquiring rights, variation of contracts and release of obligations. If a company makes payment relating to these events such payment must be made out of the company’s distributable profits.
Section 706
Where a limited company makes a purchase of its own shares in accordance with sections 690 to 708 then:
(a) if treasury shares (see sections 724 to 732), the shares may be held and dealt with in accordance with sections 724 to 732;
(b) for other shares the shares are treated as cancelled and the amount of the company’s issued share capital is diminished by the nominal value of the shares cancelled.
Section 707
‘Return to Registrar of purchase of own shares’
Where a company purchases shares in accordance with sections 690 to 708, it must deliver a return to the registrar within the period of 28 days beginning with the date on which the shares are delivered to it.
The return must
(a) distinguish between treasury shares and other shares;
(b) distinguish between treasury shares which are cancelled and not cancelled;
(c) state, with respect to shares of each class purchased, the number and nominal value of the shares and the date on which they were delivered to the company;
(d) for a public company, also state the aggregate amount paid by the company for the shares and the maximum and minimum prices paid in respect of shares of each class purchased.
Particulars of shares delivered to the company on different dates and under different contracts may be included in a single return. In such a case the aggregate amount required to be stated under paragraph (d) above is the aggregate amount paid by the company for all the shares to which the return relates.
Section 708
‘Notice to registrar of cancellation of shares’
Where a company purchases any of its own shares and those shares are cancelled, the company must give notice of cancellation to the registrar within the period of 28 days beginning with the date on which the shares are delivered to it, specifying the shares cancelled.
The notice must be accompanied by a statement of capital stating with respect to the company's share capital immediately following the cancellation:
(a) the total number of shares of the company;
(b) the aggregate nominal value of those shares;
(c) for each class of shares-
   (1) prescribed particulars of the rights attached to the shares;
   (2) the total number of shares of that class; and
   (3) the aggregate nominal value of shares of that class; and
(d) the amount paid up and the amount (if any) unpaid on each share (whether on account of the nominal value of the share or by way of premium).

Sections 709 to 723 relate to private company redemption or purchase own shares out of capital.

Section 709
Subject to any restriction or prohibition in the company's articles, a private company may in accordance with sections 709 to 723, make a payment in respect of the redemption or purchase of its own shares otherwise than out of distributable profits or the proceeds of a fresh issue of shares.

Section 710
The permissible capital payment is the payment that may be made by a company out of capital in respect of the redemption or purchase of its own shares is such amount as, after applying for that purpose any available profits of the company and the proceeds of any fresh issue of shares made for the purpose of the redemption or purchase, is required to meet the price of redemption or purchase.

Sections 711 and 712 explain how 'available profits' are calculated.

Section 713
A payment out of capital by a private company for the redemption or purchase of its own shares is not lawful unless
(1) the company's directors make a statement and the auditors make a report under section 714;
(2) the payment is approved by special resolution under section 716; and
(3) the company must publicise the proposed payment under section 719; and
(4) the directors’ statement and auditor’s report to be available for inspection under section 720.

Section 714
(a) The company's directors must make a statement in accordance with this section.
(b) The statement must specify the amount of the permissible capital payment for the shares in question.
(c) It must state that, having made full inquiry into the affairs and prospects of the company, the directors have formed the opinion;
   (i) 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
   (ii) as regards its prospects for the year immediately following that date, that having regards to
      1. their intentions with respect to the management of the company's business during that year, and
      2. the amount and character of the financial resources that will in their view be available to the company during that year, 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.
   (d) In forming their opinion for the purposes of subsection (c)(i), the directors must take into account all of the company's liabilities (including any contingent or prospective liabilities).
(e) The directors’ statement must be in the prescribed form and must contain such information with respect to the nature of the company's business as may be prescribed.
(f) It must in addition have annexed to it a report addressed to the directors by the company's auditor stating that:
   (i) he has inquired into the company's state of affairs,
   (ii) 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 sections 710 to 712, and
Section 715
If a director makes a statement under section 714 without having reasonable grounds an offence is committed.

Section 716
(1) The payment out of capital must be approved by a special resolution of the company.
(2) The resolution must be passed on, or within the week immediately following, the date on which the directors make the statement required by section 714.
(3) A resolution under this section is subject to:
Section 717 (exercise of voting rights), and
Section 718 (disclosure of directors' statement and auditors' report).

Section 717
This section restricts the voting rights attached to the shares to be redeemed.

Section 718
The directors' statement and auditor's report under section 714 should be sent to eligible members (in the case of a written resolution) or made available for inspection at the meeting at which the vote is to take place.

Section 719 (Public notice of proposed payment)
(1) Within the week immediately following the date of the resolution under section 716 the company must cause to be published in the Gazette a notice:
(a) stating that the company has approved a payment out of capital for the purpose of acquiring its own shares by redemption or purchase or both;
(b) specifying the date of the resolution and the amount of the permissible capital payment for the shares in question;
(c) stating where the directors' statement and auditor's report required by section 714 are available for inspection, and
(d) stating 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 under section 721 for an order preventing the payment.
(2) Within the week immediately following the date of the resolution the company must also either:
(a) cause a notice to the same effect as that required by subsection (1) to be published in an appropriate national newspaper, or
(b) give notice in writing to that effect to each of its creditors.
(3) 'An appropriate national newspaper' means a newspaper circulating throughout the part of the UK in which the company is registered.
(4) Not later than the day on which the company:
(a) first publishes the notice required by subsection (1), or
(b) if earlier, first publishes or gives the notice required by subsection (2), the company must deliver to the registrar a copy of the directors' statement and auditor's report required by section 714.
Appendix 2

Extract from the Auditing Practices Board bulletin 2008/9 ‘Report when a private company wishes to redeem or purchase its own shares out of capital (Section 714(6) of CA 2006) effective 1 October 2009.

REPORT WHEN A PRIVATE COMPANY WISHES TO REDEEM OR PURCHASE ITS OWN SHARES OUT OF CAPITAL (SECTION 714(6) OF CA 2006) Effective 1 October 2009

A payment out of capital by a private company for the redemption or purchase of its own shares is not lawful unless the requirements of sections 714, 716, 719, 720 and 721 of CA 2006 are met. Section 716 of CA 2006 requires that a payment out of capital must be approved by special resolution which must be passed on, or within the week immediately following, the date on which the directors make the statement required by section 714 of CA 2006.

Directors’ statement
To make a payment out of capital the directors are required by sections 714(1) to (5) of CA 2006 to make a statement specifying the amount of the permissible capital payment for the shares in question. Section 714(3) requires the directors to state that, having made full inquiry into the affairs and prospects of the company, 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
   (ii) the amount and character of the financial resources that will in their view be available to the company during that year,
   (iii) 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.

In forming their opinion, in respect of paragraph 58(a) above, the directors are required to take into account all of the company's liabilities (including any contingent or prospective liabilities).

The permissible capital payment (section 710 of CA 2006)
The payment that may be made out of capital is described as the “permissible capital payment” and is such amount as, after applying:
   (a) any available profits of the company; and
   (b) the proceeds of any fresh issue of shares made for the purposes of the redemption or purchase is required to meet the price of redemption or purchase.

Determination of available profits (sections 711 and 712 of CA 2006)
The available profits of the company are determined as follows:

1. First, determine the profits of the company by reference to the following items as stated in the relevant accounts (see paragraph 62):
   (a) profits, losses, assets and liabilities;
   (b) provisions of the following kinds:
      (i) where the relevant accounts are Companies Act accounts, provisions of a kind specified for the purposes of this subsection by paragraph 4 of Schedule 9 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008/26 or by paragraph 4 of Schedule 7 to The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008/27 by regulations under section 396 of CA 2006;
      (ii) where the relevant accounts are IAS accounts, provisions of any kind.
   (c) share capital and reserves (including undistributable reserves).

2. Second, reduce the amount so determined by the amount of:
(a) any distribution lawfully made by the company
(b) any other relevant payment lawfully made by the company out of distributable profits, after the date of the relevant accounts and before the end of the relevant period (see paragraph 62).

3. The resulting figure is the amount of available profits.

The ‘relevant accounts’ are any accounts that:

(a) are prepared as at a date within the relevant period, and
(b) are such as to enable a reasonable judgment to be made as to the amounts of the items mentioned under “1” in the above table.

The ‘relevant period’ means the period of three months ending with the date on which the directors’ statement is made in accordance with section 714 of CA 2006.

Report by the company’s auditor
The directors’ statement is required by section 714(6) to have annexed to it a report addressed to the directors by the company’s auditor (see example below) stating that:

(a) it 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 its view properly determined in accordance with sections 710 to 712 of CA 2006
(c) it is not aware of anything to indicate that the opinion expressed by the directors in their statement as to any of the matters mentioned in subsection (3) of section 714 of CA 2006 is unreasonable in all the circumstances.

The directors’ statement and therefore the annexed auditor’s report are required to be made in the week before the resolution is passed specifying the amount of the permissible capital payment for the shares in question. The auditor’s report cannot be dated earlier than the date of the director’s statement to which it relates. The date of the auditor’s report is the date on which the auditor signs its report expressing its opinion.

There is no provision for the auditor’s report to be other than unqualified. Unless the opinion is unqualified the auditor does not issue a report.

REPORT WHEN A PRIVATE COMPANY WISHES TO REDEEM OR PURCHASE ITS OWN SHARES OUT OF CAPITAL
Effective 1 October 2009

REPORT OF THE INDEPENDENT AUDITOR TO THE DIRECTORS OF XYZ LIMITED PURSUANT TO SECTION 714(6) OF THE COMPANIES ACT 2006

We report on the attached statement of the directors dated..., prepared pursuant to the Companies Act 2006, in connection with the company’s proposed [purchase]/[redemption] of... (number) [ordinary]/[preferred] shares by a payment out of capital.

Basis of opinion
We have inquired into the company’s state of affairs in order to review the bases for the directors’ statement.

Opinion
In our opinion the amount of £... specified in the directors’ statement as the permissible capital payment for the shares to be [purchased]/[redeemed] is properly determined in accordance with sections 710 to 712 of the Companies Act 2006.

We are not aware of anything to indicate that the opinion expressed by the directors in their statement as to any of the matters mentioned in section 714(3) of the Companies Act 2006 is unreasonable in all the circumstances.

Statutory auditor
Address

Date
Appendix 3

Example of a special resolution and notice of special resolution

Section 283(1) Companies Act 2006 says:

‘A special resolution of the members (or of a class of members) of a company means a resolution passed by a majority of not less than 75%.’

Section 307 Companies Act 2006 says

‘A general meeting of a private company (other than an adjourned meeting) must be called by notice of at least 14 days.’

A general meeting of a public company (other than an adjourned meeting) must be called by notice of at least 21 days for an annual general meeting and in any other case, at least 14 days.

The company’s articles may require a longer period of notice.

A general meeting may be called by shorter notice than that otherwise required if shorter notice is agreed by the members.

Example of Special Resolution and Notice of Special Resolution

Notice is hereby given that a general meeting of XYZ PLC will be held at 1 High Road, London W1 1AA on 1 December 2012 to consider and if deemed fit to approve the following resolution:

SPECIAL RESOLUTION

That the members of XYZ PLC authorise the company, pursuant to section 694 Companies Act 2006, to make an off-market purchase of 10,000 of its ordinary shares at a price of £4 per share. The company is authorised to make the purchase any time from the close of this meeting to 31 January 2013 inclusive.

Dated this 31 October 2012

By order of the Board

Signed .................................

Company Secretary

Address of registered office
Appendix 4

Extract from HMRC publication SP2/82 company's purchase of own shares

HMRC Statement of Practice 2/82 (SP2/82) refers to ICTA 1988 sections 212 to 232. These sections have been replaced by CTA 2010 sections 1029 to 1063.
SP2/82 Company's purchase of own shares: ICTA 1988 (See also Inland Revenue Tax Bulletin, Issue 21, February 1996, page 280)

Where a company makes a purchase of own shares which involves a payment in excess of the capital originally subscribed for the shares, the excess constitutes a distribution. However, such a payment is treated as not giving rise to a distribution if, among other conditions, the purchase is made wholly or mainly to benefit a trade carried on by the company, or by one of its 75% subsidiaries. This Statement indicates how this test is applied by HM Revenue and Customs.

The Annex to this Statement gives guidance on how companies should apply for a ruling on whether or not a purchase will be treated as a distribution.

Section 219(1)(a) - The ‘Trade Benefit Test’

1. The Company's sole or main purpose in making the payment must be to benefit a trade carried on by it or by its 75% subsidiary. The condition is not satisfied where, for example, the transaction is designed to serve the personal or wider commercial interests of the vending shareholder (although usually he will benefit from it) or where the intended benefit for the company is to some non-trading activity which it also carries on.

2. If there is a disagreement between the shareholders over the management of the company and that disagreement is having or is expected to have an adverse effect on the company's trade, then the purchase will be regarded as satisfying the trade benefit test provided the effect of the transaction is to remove the dissenting shareholder entirely. Similarly, if the purpose is to ensure that an unwilling shareholder who wishes to end his association with the company does not sell his shares to someone who might not be acceptable to the other shareholders, the purchase will normally be regarded as benefiting the company's trade. Examples of unwilling shareholders are:
   - an outside shareholder who has provided equity finance (whether or not with the expectation of redemption or sale to the company) and who now wishes to withdraw that finance
   - a controlling shareholder who is retiring as a director and wishes to make way for new management
   - personal representatives of a deceased shareholder, where they wish to realise the value of the shares
   - a legatee of a deceased shareholder, where he does not wish to hold shares in the company.

3. If the company is not buying all the shares owned by the vendor, or if although the vendor is selling all his shares he is retaining some other connection with the company - for example, a directorship or an appointment as consultant - it would seem unlikely that the transaction could benefit the company's trade, so the trade benefit test will probably not be satisfied. However, there are exceptions; for example, where a company does not currently have the resources to buy out its retiring controlling shareholder completely but purchases as many of his shares as it can afford with the intention of buying the remainder where possible. In these circumstances, it may still be possible for the company to show that the main purpose is to benefit its trade. Also, the Commissioners for Her Majesty's Revenue and Customs do not raise any objection if for sentimental reasons it is desired that a retiring director of a company should retain a small shareholding in it, not exceeding 5% of the issued share capital.

Annex To SP2/82
Applications for advance clearance under S.225 ICTA 1988
Procedure
If clearance under S.225 is desired the application should be sent to:
HMRC Clearance and Counteraction Team
Anti-Avoidance Group
First Floor
If clearance is also being sought under Section 707, ICTA 1988 a single application may be made under both provisions and should be directed to the address given above with an extra copy of the application and enclosures. Such an application should open by stating clearly the provisions under which it is made and should be expanded to include any additional information needed for the application under the other provision.

Form of application - General
Sections 219-229 contain conditions which must be satisfied before the tax treatment afforded by S.219 can apply. A comprehensive application which has regard to each of these conditions will remove the need for lengthy fact finding enquiries and enable the Commissioners for Her Majesty's Revenue and Customs to come to a decision on the application with the minimum of delay.

To assist companies in preparing clearance applications under Section 225 and to facilitate their consideration by the Commissioners for Her Majesty's Revenue and Customs, an outline of the basic information needed is given below. However, it is not an exhaustive list, and in giving the particulars of the relevant transactions required by Section 225(2) the applicant must fully and accurately disclose all facts and circumstances material for the decision of the Commissioners for Her Majesty's Revenue and Customs (Section 225(5)).

In what follows, references to purchase of shares include references to repayment or redemption of shares. It will be helpful if applications follow the order set out below, each item being expanded as necessary and any further information being added at the end.

Application for clearance under Section 225(1)(a)
It should be stated at the outset whether the purchase of shares is regarded as falling within Section 219(1) by virtue of (a) or (b). If the purchasing company has previously made any application under Section 225 it will be helpful if the Commissioners for Her Majesty's Revenue and Custom's reference(s) can be quoted.

A. Purchases within Section 219(1)(a)
1. The Company.
   a. the name of the company making the purchase;
   b. its Tax District and reference;
   c. confirmation that it is an unquoted company as defined in Section 229(1);
   d. its status, that is, 'trading company' or 'holding company of a trading group' within the Section 229(1) definitions or some other type of company not within the definitions.

2. Groups.
   Where the company is a member of a group (see below):
   a. the names of the group companies together with their Tax Districts and references;
   b. a statement or diagram showing the shareholding interests of each group company in other group companies. A group for the purpose of this paragraph is the largest 51 per cent group to which the purchasing company belongs (Section 222(9)), but the meaning of 'group' is extended, where appropriate, by Section 222(10)) and (12).

3. The Payment.
   a. Details of the shares to be purchased, the name of their present owner, the purchase price and the method of payment.
   b. Details of any other transactions between the company and the vendor at or about the same time.
   c. Confirmation that the company's Articles of Association allow it to purchase its own shares.

4. Shareholders.
   a. A list of the current shareholders in the purchasing company, and where appropriate, in each company in a group as in 2 above, together with particulars (amount, class, dividend rights etc) of their current holdings;
b. a statement of any relationships of the shareholders to each other;
c. where the shareholder is the son or daughter of another shareholder, an indication that he or she is over 18 or else details of their age.

5. Prior transactions.
Particulars of any prior transactions or rearrangements to be carried out in preparation for the purchase.

6. Purpose and benefits.
A statement of the reasons for the purchase, the trading benefits expected and any other benefits expected to accrue, whether or not to the purchasing company.

Confirmation, together with all relevant information, that the purchase etc does not form part of a scheme or arrangement the main purpose or one of the main purposes of which is to enable the owner of the shares to participate in the profits of the company without receiving a dividend, or the avoidance of tax. Confirmation that the vendor will receive no other payment from the company, or details of any such payment to be made.

   a. the present residence status of the vendor and any intended change (Section 220);
   b. the tax district, reference and National Insurance number of the vendor, or if not known his or her private address (Section 220);
   c. the period of beneficial ownership by the vendor of the shares to be purchased (Section 220(5));
   d. confirmation, if appropriate, that the vendor's interest will be ‘substantially reduced’ Section 221(1));
   e. confirmation, if appropriate, that the combined interests as shareholders of the vendor and his ‘associates’ (see Section 227) will be substantially reduced (Section 221(2));
   f. confirmation, if appropriate, that the vendor's interest as a shareholder in the group will be substantially reduced (Section 222(1));
   g. confirmation, if appropriate, that the combined interests as shareholders in the group of the vendor and his associates will be substantially reduced (Section 222(3));
   h. confirmation that the vendor will not, immediately after the purchase, be ‘connected with’ (see Section 228) the company making the purchase or with any company which is a member of the same group as that company (Section 223(1));
   j. confirmation that the purchase is not part of a scheme or arrangement within Section 223(2).

The application should be accompanied by -
   a. copies of the latest available financial statements for the purchasing company and for any group companies (see paragraph 2 above), and in the case of a group the financial statements for the group;
   b. a note of any material relevant changes since the balance sheet date or confirmation that there are none;
   c. details of any loan or current account which the vendor maintains with the company or with any group company.

B. Purchase within Section 219(1)(b)

1. Company.
   a. The name of the company making the purchase;
   b. its Tax District and reference;
   c. confirmation that it is unquoted as defined in Section 229(1);
   d. its status, i.e. ‘trading company’ or ‘the holding company of a trading group’ within the definitions in Sections 229(1), or some other type of company not within the definitions.

2. Groups.
Where the company is a member of a group (see A.2 above):
   a. The names of the group companies together with their Tax Districts and references;
   b. a statement or diagram showing the shareholding interests of each group company in other group companies.

3. The Payment.
a. Details of the shares to be purchased, the name of the present owner, the purchase price and method of payment.
b. Details of any other transactions between the company and the vendor at or about the same time;
c. confirmation that the company's Articles of Association allow it to purchase its own shares.

4. Inheritance Tax.
   a. The name and date of death of the deceased;
   b. the reference of the deceased at the Capital Taxes Office;
   c. the amount of the outstanding tax and whether or not liability has been finally agreed;
   d. the extent to which the purchase price is to be applied in satisfaction of the tax liability;
   e. a full explanation of the circumstances in which there would be ‘undue hardship’ if the tax liability were to be discharged otherwise than through the purchase of own shares from this or another such company;
   f. the Tax District and reference of the person to whom undue hardship would be caused or if not known the address of that person, and their National Insurance Number.

5. Accounts and other financial information.
The application should be accompanied by -
   a. copies of the latest available financial statements for the purchasing company and for any group companies (see paragraph A.2 above), and in the case of a group the financial statements for the group;
   b. a note of any material relevant changes since the balance sheet date or confirmation that there are none.

Applications for clearance under Section 225(1)(b)

1. Company.
   a. The name of the company making the purchase;
   b. its tax district and reference.

2. The payment.
   a. Details of the shares to be purchased, the vendor, the purchase price and the method of payment.
   b. confirmation that the company's Articles of Association allow it to purchase its own shares.

3. Account and other financial information.
   a. Copies of the latest available financial statements for the purchasing company;
   b. A note of any material relevant changes since the balance sheet date or confirmation that there are none.

4. A statement of the reasons why it is believed that the proposed payment does not fall within the provisions of Section 219.
Appendix 5

HMRC issued the following guidance in Tax Bulletin 21 which is still relevant

PURCHASE BY AN UNQUOTED COMPANY OF ITS OWN SHARES

As a general principle, where a company makes a purchase of its own shares (a ‘PoS’), any excess paid over the
amount of capital originally subscribed for the shares is a distribution. However, under Section 219 Income and
Corporation Taxes Act (ICTA) 1988, where none of the company's shares are listed in the Stock Exchange Official List
the excess is not treated as a distribution if various conditions are satisfied.

Under Section 225 ICTA 1988 companies intending to make a PoS can request the Board of Inland Revenue to say in
advance whether they are satisfied that Section 219 ICTA 1988 will apply (or that it will not apply) to any such excess.
If the Board indicate that they are satisfied, that statement is ordinarily binding on the Revenue. Thus a clearance
enables the company to know whether or not it will need to account for ACT on the excess. In most cases both the
company and the vendor hope to obtain Section 219 ICTA 1988 treatment, but sometimes distribution treatment is
found to be advantageous.

The procedure for obtaining clearance from the Board is set out in the Annex to Statement of Practice 2/82, which was
revised in 1994 and can be found in its new form in the booklet IR131 ‘Inland Revenue Statements of Practice’. The
following notes deal with various matters which we find are sometimes overlooked or misunderstood.

- The Board can only consider a request relating to a transaction which appears to be a valid PoS. The
  Companies Act 1985 lays down certain procedural rules which must be followed. Also, the consideration for
  the shares must be paid immediately and must be paid in money. The first of these requirements means that
  payment by instalments is not possible. It is, however, possible to make a contract under which successive
  tranches of shares are to be purchased on specified dates.

- One simple rule which is often forgotten is that under Section 220 ICTA 1988 the shares must have been held
  for 5 years. There are relaxations where, for example, the vendor acquired the shares under the will of the
  previous owner, or in exchange for other shares as part of a company reconstruction. But those exceptions
  apart, if it is less than 5 years since the company was incorporated, the rule cannot be satisfied and Section
  219 ICTA 1988 cannot apply.

- Another rule which is sometimes overlooked is that Section 219 ICTA 1988 can only apply if the company is a
  ‘trading company’, which is defined in Section 229 ICTA 1988 as a company whose business consists wholly
  or mainly of carrying on a trade. (Alternatively it can be a member of a trading group, in which case the
  businesses carried on must in aggregate consist wholly or mainly of trades). As the definition itself implies, not
  every business is a trade -- for example, property investment is not a trade. Furthermore, for this particular
  purpose trading does not include dealing in shares, securities, land or futures. Finally, it is not enough that the
  company used to be, or hopes to be, a trading company; it must be one when the PoS takes place.

- For Section 219 ICTA 1988 to apply it is necessary (except in the special circumstances mentioned in Section
  219(1)(b)) for the PoS to have the main purpose of benefiting a trade carried on by the company (or its
  subsidiary). Guidance on the Board's view of this requirement can be found in SP2/82.

In many cases the benefit in view is of such a nature that it can only be secured if the shareholder is bought out
completely. Even where that is not the case, it is still necessary to ensure that the number of shares purchased is such
that two arithmetical tests are met. First, the percentage of share capital held by the vendor (and his associates)
immediately after the purchase must be less than three quarters of the percentage held immediately before it (see
Section 221). Secondly, following the purchase the vendor (and his associates) must not be ‘connected’ with the
company as defined in Section 228 ICTA 1988 -- that is, broadly, must not have interests in the company totaling more
than 30%.

It sometimes happens that the company wants to buy out the shareholder completely but cannot afford to do so. In
such a case, the parties may agree that the PoS should go ahead but that the shareholder will lend part of the
consideration back to the company immediately afterwards. There is no reason why that should not happen. However,
it should be remembered that after the PoS the shareholder's interests in the company must not exceed 30%; where the
shares have a high market value, the issued share capital being relatively small, it is possible that the loan may cause
this rule to be breached. It is acceptable for the company to avoid this result by making a bonus issue before the PoS takes place, thus increasing its issued share capital.

**Example**

Norman owns 3,000 out of the 10,000 issued £1 shares of a company. It is agreed that the company will buy the shares for £50,000, which is their market value, and that Norman will then lend the company £25,000. But this would mean that Norman held loan capital of £25,000 out of the company's combined share and loan capital of £32,000, so he would be connected with the company, and both parties are agreed that they would prefer the transaction to come within Section 219.

So before making the PoS the company makes a bonus issue of 9 shares for each one held. Norman then sells back his 30,000 shares for £50,000 and lends the company £25,000. He now holds loan capital of £25,000 out of the company's combined share and loan capital of £95,000, and since this is less than 30% of the whole he is not connected with the company.

Every year something like 1,500 companies request clearance from the Board for a proposed PoS. We try to give a response well within the statutory deadline of 30 days, but in some cases that response has to take the form of a request for further information. It is therefore advisable to allow a reasonable time for a decision to be reached and not to leave the application until the last moment.

Finally, Section 226 ICTA 1988 requires a company to make a 'return' to the Inspector dealing with its affairs if it purchases its own shares and does not treat the payment as giving rise to a distribution -- that is, does not account for ACT. This must be done within sixty days after the purchase. The requirement applies whether or not clearance was requested. If clearance was requested the Inspector will have received a copy of the letter of clearance (or refusal), so all that is needed is a short letter detailing any changes from the arrangements advised to the Board and reporting the date of the transaction. If clearance was not requested, the Inspector will need to know the date of the purchase, the name of the vendor, the number of shares and the amount of the consideration, and the grounds on which it was considered that the 'trade benefit' test was satisfied.