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# Important Issues to Bear in Mind on a Company Share Buyback

Share buybacks are now a common method used by companies to return surplus cash to shareholders, increase earnings per share, increase gearing and provide an exit route for shareholders. Not only are they a useful commercial tool for companies but, depending upon tax advice, the relevant shareholder may be able to avail him/herself of preferable tax treatment whereby the return can be treated as a tax on a chargeable gain as opposed to a tax on income.

Having been instructed on a number of share buybacks recently, we have identified some important issues below which may need to be borne in mind when you are looking to effect a company share buyback.

We would note that the statutory requirements under the Companies Act 2006 ("CA 06") in respect of share buybacks are stringent. If they are not adhered to then this can cause significant problems for both the

company and its shareholders further down the line. It is worth noting that the legal consequences of not complying with the share buyback requirements under Part 18 of CA 06 may mean that the acquisition is void and, further, that an offence is committed by the company and every officer of the company in default. Needless to say therefore- it really is worth taking the time to ensure that your company's share buyback is done properly!

A company may purchase back its own shares by financing that purchase out of distributable profits or out of its capital. We are most commonly instructed on share buybacks that are "off-market" purchases i.e. private company transactions that are funded out of distributable profits. In this context, the following are important points to bear in mind:

The shares that are the subject of the buyback will need to be fully paid. If they are not fully paid up the shares cannot be bought back. You will normally find a record of whether the company's shares are paid up in the share register in the company's books.

1. The sale price for the shares must be "paid for" on completion of the purchase of the shares. In other words, the consideration cannot be paid by instalments (*Pena v Dale [2003] EWHC 1065 (Ch)*). If this poses issues from a cashflow perspective for the company then you may be able to get around this by staging the buyback of shares so that there are multiple completion dates, where the total number of shares are bought back in tranches.
2. The company will need to have sufficient "distributable profits" to meet the consideration for the repurchase of shares. It may seem obvious but, for the avoidance of doubt, the actual share capital of the company and any share premium should not count as distributable profits.
3. There must be a contract in respect of the share buyback (known as the "share buyback agreement") which is approved by a shareholders' resolution either before the contract is entered into or after a contract is entered into but provided that no shares may be repurchased under the contract until the terms of the contract have been authorised by a

shareholder resolution.

4. You will need to ensure that the share buyback agreement is compliant with the tax advice given by the company's tax adviser in order that the consideration for the share buyback obtains tax treatment that is chargeable to capital gains tax as opposed to income tax.
5. As noted above, from a cashflow perspective, the company may need to stage the buyback of shares so that the shares are bought back in tranches. The share buyback agreement will therefore need to be carefully drafted to ensure that the transaction gets the tax treatment sought whilst still meeting the legal requirements for share buybacks under CA 06.
6. One of the key requirements to achieve capital gains tax treatment for a share buyback is that there must be a single unconditional contract under which the shareholder sells his/ her entire beneficial interest in the shares. Where there may be multiple completion dates under the share buyback agreement, you may, as a seller, wish to retain voting rights, dividend rights or rights to capital on a winding-up of the company in the interim period until the buyback of the relevant tranche of shares is completed. If you do expressly state that such rights are to stay with you as the seller during the interim period then, from a tax perspective, this may mean that the transaction is treated as being chargeable to income tax as opposed to capital gains tax as the whole of the beneficial interest in the shares will not have transferred at the outset and the contract may also be deemed to be conditional. The parties therefore would need to consider what is more important to them: preserving capital gains tax treatment or ensuring that the shareholder has rights to dividends (for example) during the interim period to completion of the acquisition of the relevant tranche of shares.

I would hope that the above has demonstrated that share buybacks are quite a complex area of law that need careful consideration in order to ensure that the legal requirements are met and that ultimately both the

company and the shareholder are able to benefit from having a valid share buyback. If you have any further queries with regard to share buybacks or in respect of any other corporate or commercial matters, please contact myself or a [member of our team](#).