

COMPANY

LAW

TREASURY SHARES

A CONSULTATIVE DOCUMENT

SEPTEMBER 2001

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1 INTRODUCTION

1.1 DTI issued a consultative document in May 1998 (entitled "Share Buybacks") which sought views on whether there should be a change to company law under which a company that purchases its own shares is required to cancel them. The present law prohibits purchased shares being held "in treasury" for resale at a later date. The previous consultative document pointed out that allowing the resale of shares would give companies greater flexibility to adjust their share capital and might therefore lead to a reduction in companies' overall cost of capital. It could, as a result, stimulate investment. However, any change in the law to allow shares to be held in treasury would need to be accompanied by other changes, such as greater disclosure requirements, if the balance of the present law - which was designed to ensure a fair market in a company's shares and also to protect the interests of creditors and others who do business with a company - were not to be disturbed. A summary of responses to the consultative document was published in October 1998. Both documents have been posted on DTI's Company Law and Investigations Consultation Documents website (www.dti.gov.uk/cld/condocs.htm).

1.2 On 22 December 1999, Dr Kim Howells, then Parliamentary Under Secretary of State for Competition and Consumer Affairs at the Department of Trade and Industry, announced that he had decided to deregulate company law in respect of the holding of shares in treasury. A copy of the announcement is at Annex B (it has also been placed on the DTI website referred to in paragraph 1.1 above). The Minister stated that the next stage would be the publication for consultation of draft amending regulations and this document represents that next stage.

Deadline for comments

1.3 Comments on the draft regulations at Annex C or on any issue raised in this consultative document should be submitted by **30 November 2001** and preferably by e-mail to:-

Peter Brower
Department of Trade and Industry
Company Law and Investigations Directorate (Room 507)
1 Victoria Street
London SW1H 0ET

Tel: 020-7215 0224. Fax: 020-7215 0234. E-mail: peter.brower@dti.gov.uk

A summary of the questions in this consultative document is reproduced at Annex A and consultees may wish to make use of this annex when replying. However, comments on any issue raised in the consultative document (or, indeed, any issue not covered) would be welcomed by the Department as would comments on the draft regulations at Annex C.

1.4 This document has also been placed on DTI's website referred to in paragraph 1.1 above. Copies may also be obtained from Robert Ellis (telephone 020-7215 0409, fax 020-7215 0234, e-mail robert.ellis@dti.gov.uk).

1.5 The changes to tax law proposed by the Inland Revenue, consequential to the proposed changes to company law, are set out at section 6 and Annex D. Any queries or comments about these changes should be directed to:-

Mark Bravery
Inland Revenue
Business Tax Division - 4th Floor
22 Kingsway
London WC2B 6NR

Tel: 020-7438 6418. Fax: 020-7438 6815. E-mail: Mark.Bravery@ir.gsi.gov.uk

Timing of the introduction of the regulations

1.6 It is planned to introduce regulations as soon as possible. It should be noted that the proposed changes to tax law referred to in paragraph 1.5 above and outlined at Annex D will be introduced by separate legislation. However, it is intended that the tax law changes and the company law changes will come into force on the same date.

Costs, savings and benefits

1.7 A draft regulatory impact assessment (RIA) which takes into account the views of those consultees who responded to the previous consultative document is at Annex E. Comments on the RIA would be welcomed and, in particular, on the savings or other benefits (or any costs) that would be expected to result from the proposed regulations. Paragraph 6 of the RIA sets out the few comments that were previously received on savings but includes only one actual estimate of those savings. It is intended that the final RIA will also cover the tax consequences of the changes to company law. At present, the RIA does not include references to this aspect and it is not anticipated that the proposals set out in section 6 and Annex D will have any significant regulatory impact. However, comments would be welcomed on this point.

Open Government

1.8 Under the Code of Practice on Access to Government Information comments may be made publicly available unless consultees specifically request otherwise. Consultees should therefore indicate if they wish their responses to this consultative document to be regarded as confidential. A summary of all the responses received will be prepared and circulated to all consultees who respond to this consultative document and to anyone else who requests one. It will also be placed on the DTI website referred to in paragraph 1.1 above. The summary will not identify respondents.

2 RESULTS OF THE PREVIOUS CONSULTATION AND PROPOSED REQUIREMENTS IN THE DRAFT REGULATIONS

2.1 The previous consultative document raised a number of issues. These issues, along with the Department's proposals, are set out below. Further issues that were raised during the consultation process (or subsequently) where it is proposed that the Companies Act 1985 (the 1985 Act) be amended are set out in section 3. Other issues where the views of consultees are sought but where the draft regulations do not presently include any proposed change to the 1985 Act are set out in section 4. Finally, minor proposed consequential changes to the 1985 Act are set out in section 5.

2.2 It is not proposed that any of the existing company law requirements relating to the purchase by a company of its own shares should be amended. These requirements include that members must agree a proposed purchase by a company of its own shares; that members must agree the maximum number of shares to be acquired, the duration of the period for which the authorisation is given (which may not be more than eighteen months) and the minimum and maximum price to be paid for the shares; and that details of purchases need to be included in companies' annual reports.

2.3 Nothing in the draft regulations would amend companies' articles of association. In the event that a company's articles included provisions which would prohibit it from holding shares in treasury which would otherwise be permitted under the regulations, the company would need to obtain shareholder approval to change its articles in the same way that it would obtain shareholder approval to any other change to its articles. It would also be open to companies, if their shareholders agreed, to include provisions relating to treasury shares in their articles which were more onerous than those set out in the draft regulations.

Basic provisions permitting companies to hold shares in treasury for resale at a later date

2.4 The draft regulations provide (by the amendment of section 162 of the 1985 Act made by Regulation 2, and by new sections 162A and 162B of the 1985 Act inserted by Regulation 3) that where companies meeting the description in paragraph 2.6 below purchase their own shares, such shares shall not automatically be cancelled but may, subject to limits, be held by the company in treasury for subsequent resale. The aggregate nominal value of shares held in treasury may not at any time exceed 10% of the nominal value of the issued share capital of the company (or, where the company's share capital is divided into shares of different classes, 10% of each class). If that maximum is exceeded at any time, the excess shall be automatically cancelled. It therefore follows that if a company purchased 15% of a particular class of shares, it would be required to cancel at least 5% of them. Conversely, if a company held 5% of a particular class of shares in treasury following an earlier

purchase of its shares it would be restricted, in any subsequent purchase, to holding a further 5% of those shares in treasury.

2.5 The new sections 162(2B) and 162A(1) stipulate that a company that purchases shares for holding in treasury may do so only out of distributable profits. It seems highly unlikely that a company would want to finance the purchase of shares for holding in treasury from the proceeds of a fresh issue of shares. Moreover, if the purchase of shares for holding in treasury were to be financed from a new issue, the regulations would need to provide how the proceeds from a sale of treasury shares would be dealt with. Accordingly, if companies were permitted to finance the purchase of shares for holding in treasury out of the proceeds of a fresh issue of shares, it would appear to be necessary to provide for:-

- i) the identification of treasury shares based on their method of financing, ie from the proceeds of a fresh issue of shares or from distributable profits;
- ii) the implementation of Article 22.1(b) of the Second Company Law Directive (see paragraph 2.23 below); and
- iii) possible additional capital maintenance and accounting provisions.

Such provisions would make the regulations longer and more complex. If the Department is correct in its assumption that companies would not want to finance the purchase of shares for holding in treasury from the proceeds of a fresh issue of shares, then there would be no advantage in the regulations permitting such an option, particularly in the light of the need to incorporate the additional requirements identified in i) - iii) above. Consultees' views would be welcomed on whether there is likely in practice to be any demand to finance the purchase of treasury shares from the proceeds of a fresh issue of shares. If consultees consider that such demand is likely and that this option should therefore be included in the regulations, consultees' views are requested on the treatment of the proceeds of a sale of any treasury shares financed from the proceeds of a fresh issue of shares and on the additional requirements identified in i) - iii) above. Shares which are purchased for immediate cancellation may continue to be financed out of the proceeds of a fresh issue of shares.

Companies which would be affected by a change to the law

2.6 The change to the 1985 Act allowing companies to hold shares in treasury would apply only in respect of shares which are defined as qualifying shares in the regulations (new section 162(4) of the 1985 Act inserted by Regulation 2 of the draft regulations). In broad terms, this covers the shares of public companies which are quoted on the London Stock Exchange's main market or the Alternative Investment Market and their equivalents in other EEA

States. Other public companies, and all private companies, would not be permitted to hold shares in treasury. In addition, investment companies could not purchase their own shares for holding in treasury. This reflects the announcement by DTI - the second page of the press release at Annex B refers - but see also paragraph 2.7 below. In the event that a company held treasury shares which ceased to be qualifying shares (for example where the shares were de-listed) or the company became an investment company, the treasury shares would be automatically cancelled (new section 162E inserted by Regulation 3). The draft regulations provide that, in the event of a company having more than one class of shares, it is only the class(es) of shares that are qualifying shares that may be held in treasury (new section 162(4) inserted by Regulation 2). New section 162E provides that in the event of a company's qualifying shares being suspended, the treasury shares will not cease to be regarded as qualifying shares. Without such a provision it would follow that, if a company's qualifying shares were suspended, its treasury shares would be automatically cancelled.

2.7 The draft regulations also provide (by the amendment of section 162 made by Regulation 2) that investment companies within the meaning of section 266 of the 1985 Act may not hold shares in treasury. However, following the announcement by DTI (see the second page of the press release at Annex B) the Department has received representations from the Association of Investment Trust Companies that investment companies should not be prevented from holding shares in treasury. The Department would welcome the views of consultees on this point.

Voting rights

2.8 In line with the requirements of the Second EU Company Law Directive (Article 22(1)(a)), the draft regulations provide (new section 162C inserted by Regulation 3) that the voting rights of treasury shares are suspended. However, the draft regulations go further than the Directive by providing that companies holding treasury shares may not exercise any rights (whether to attend or vote at meetings, or otherwise) in respect of treasury shares: this reflects comments made by some respondents to the previous consultative document. The draft regulations also provide that the purported exercise of such rights is void. Accordingly, any references in the 1985 Act to members attending meetings or voting at meetings would not apply in respect of companies which are members of themselves as a result of holding treasury shares.

Cancellation or resale

2.9 The previous consultative document sought views on whether shareholders, when asked to approve a purchase of shares, should be asked to approve it either for cancellation or resale. In the light of responses received, the draft regulations include no such requirement. If a company wanted to seek an authority which was specific as to whether the approval was

for cancellation or resale it could, of course, do so. Conversely, shareholders could decide that they would only approve a purchase of shares subject to it being either for cancellation or for resale.

2.10 Views were also sought on whether there should be a provision that when a company announced its intention to purchase shares, or actually effected the purchase, it should be required to state whether the shares were to be held in treasury for resale or cancelled. Again, In the light of responses received, the draft regulations include no such requirement.

Disclosure of shares held in treasury

2.11 The previous consultative document pointed out that if companies were permitted to purchase their shares for resale, shareholders and others would arguably have an interest in knowing the percentage of the company's shares which were held in treasury. It was suggested that disclosure requirements along the lines of those applicable to shareholders under Part VI of the 1985 Act might suffice, eg an announcement could be required once the percentage of treasury shares held reached 3%, with a further requirement for announcements at each round percentage point along the scale (eg 4%, 5%, 6%) up to the maximum permitted holding of 10%. Sales of treasury shares could also be notified at each round percentage point (eg 6%, 5%, 4%) until the holding was reduced to less than 3%.

2.12 All consultees who commented considered that there should be a requirement for treasury shares to be disclosed but many considered that the purchasing, holding and sale (or cancellation) of shares for, in and from treasury was analogous with directors' dealings in shares, rather than the substantive shareholdings provisions in Part VI of the 1985 Act. Accordingly, all purchases for, and sales from, treasury of shares (or cancellation of such shares) should be required to be disclosed to the market under the appropriate rules regulating the market in the shares along with the number of shares held in treasury each time a transaction was notified. Such a requirement would mirror that under Rule 15.9 of the Listing Rules which requires listed companies to disclose all purchases of their own shares. The Department will therefore be discussing with the Financial Services Authority (FSA) and the London Stock Exchange the arrangements that should apply to achieve the appropriate disclosure of the purchase, holding and sale or cancellation of treasury shares.

Payment of dividends

2.13 The previous consultative document proposed requiring the suspension of dividends or any other payment that might otherwise be paid on any shares held in treasury on the grounds that it is pointless for companies to pay money to themselves. The draft regulations include a provision (new section 162C inserted by Regulation 3) to effect such a suspension. Indeed, the draft regulations go further by preventing a company from paying a dividend or

making any other kind of distribution of its assets including a distribution of its assets to members on a winding up - and whether in cash or otherwise - to itself as a result of it holding treasury shares. However, there is an exemption in respect of an allotment of fully paid bonus shares made at the time shares are held in treasury. There is also an exemption to enable a company to redeem treasury shares if they are redeemable shares. Bonus shares are referred to in paragraphs 3.7 - 3.9, and redeemable shares in paragraph 4.8.

Pre-emption rights

2.14 The previous consultative document sought views on whether pre-emption rights - which apply to the allotment of new shares - should be extended to apply to the sale of shares from treasury. Pre-emption rights are the rights of existing shareholders to be offered the first opportunity to purchase any new shares issued by a company in proportion to their existing shareholding. Such rights are provided in sections 89-96 of the 1985 Act. However, under section 95, where the directors of a company have a general authorisation to issue shares under section 80 of the 1985 Act, they may also be given a power, by the articles of the company or by a special resolution, to dispense with or modify the right of pre-emption. The draft regulations provide (through the amendment of section 94 inserted by paragraph 4 of the Schedule) that pre-emption rights apply to sales of treasury shares but subject to the same dispensation that applies to new shares referred to above, namely that shareholders may agree (by approving a special resolution) to their disapplication. A company's articles could also be amended so as to dispense with or modify the right of pre-emption applying to the sale of treasury shares. However, such an amendment would also need to be approved by a special resolution.

2.15 Paragraph 3 of the Schedule makes an amendment to section 89(1). Paragraph 3 of the Schedule provides that a company holding treasury shares may not offer to allot to itself any new shares which, as a result of it being regarded as a member of itself, it would otherwise be bound to do. Whilst a company could not exercise a right to subscribe for any new shares in itself (since its rights to do so would be suspended as explained in paragraph 2.8 above), without such an amendment to section 89(1), a company holding 10% of its shares in treasury would only need to offer 90% of any new shares to its existing shareholders; the remaining 10% could, in effect, be offered to anyone to whom the company wanted to offer the shares. A similar amendment to section 89(2) has also been made by paragraph 3 of the Schedule.

2.16 The Pre-emption Group issued guidelines in 1988 on the circumstances under which shareholders should agree to the disapplication of pre-emption rights to new share issues. It will be for the Group - which comprises representatives of listed companies, investment institutions and corporate finance practitioners - to decide whether those guidelines should be extended to sales of treasury shares and, if so, to consider the proposed framework for disapplication which has been drawn up by the Association of Corporate

Treasurers, Association of British Insurers and National Association of Pension Funds.

Approval by members of a sale of shares held in treasury

2.17 The previous consultative document sought views on whether there should be a requirement for members to approve a sale of treasury shares (and thus reflect the requirement for members' approval of a purchase of shares). If so, should shareholders have to approve the maximum number and price range of shares to be sold, should such approval be time limited, and should there be a requirement for approvals of resales to be notified in, say, companies' annual reports? In the light of responses, no such requirements have been included in the draft regulations.

Announcement of intention to resell shares held in treasury

2.18 The previous consultative document also sought views on whether there should be a requirement for companies to announce in advance their intention to resell treasury shares. If so, would it be sufficient for companies to indicate this fact in their annual reports? In the light of responses, no such requirement has been included in the draft regulations.

Notification of reselling shares from treasury

2.19 The previous consultative document pointed out that there was already a requirement, under the Listing Rules, for listed companies to notify a purchase of their own shares giving details of the date, number and price. It stated that the London Stock Exchange (exercising the function of Listing Authority which has now been transferred to the FSA although the Exchange retains the responsibility for setting the rules applicable to AIM companies) would no doubt wish to consider whether this requirement should be extended to notifying sales of treasury shares. Such a requirement has now been effectively subsumed by the proposed requirement outlined in paragraph 2.12 above dealing with the disclosure of shares held in treasury.

Prohibition on sale of shares from treasury at price-sensitive times

2.20 The previous consultative document also referred to the fact that under the Listing Rules (now administered by the FSA) there is a prohibition on purchases by a listed company of its own shares at a time when a director would, under the Model Code contained in the Appendix to Chapter 16, be prohibited from dealing in such securities (eg in the run up to the announcement of annual or interim results). It further stated that, in order to reduce the scope for market manipulation, the Department believed there was a strong case for a prohibition on companies selling shares from treasury at price sensitive times. Almost all consultees who commented said that there should be such a prohibition. Accordingly, the Department will be discussing with the FSA and the London Stock Exchange the approach to be taken in

respect of the sale of treasury shares at price-sensitive times under the Model Code and AIM rules respectively.

Reselling shares held in treasury when a company is subject to a takeover

2.21 The previous consultative document pointed out that the reselling of shares held in treasury raised questions in relation to takeovers and, in particular, whether there should be a prohibition on the sale of shares held in treasury whilst a company was subject to a takeover bid (unless there was prior or explicit shareholder approval). Almost all consultees who commented said that there should be such a prohibition and/or that the matter should be left to the Takeover Panel. Accordingly, the Department intends asking the Takeover Panel to consider amending the City Code to effect such a prohibition. A further point relating to takeover offers on which the Department does intend to legislate is referred to at paragraphs 3.10 - 3.11 below.

Subsidiaries

2.22 At present, company law (section 23 of the 1985 Act) generally prohibits subsidiaries from being shareholders in their holding company. This is an anti-avoidance measure to prevent companies holding their own shares through a subsidiary. It also serves as a capital maintenance safeguard. The previous consultative document sought views on whether - if treasury shares were to be permitted - section 23 should be amended so that a subsidiary could purchase, hold and resell its parent company's shares, such holdings becoming, in effect, treasury shares of the parent company. The draft regulations do not include such a relaxation and, subject to the existing minor exceptions, section 23 will continue to prohibit subsidiaries from being shareholders in their holding company.

Reporting of treasury share in the accounts

2.23 The Second Company Law Directive makes provision for the case where shares held in treasury are treated as an asset in a company's balance sheet. Article 22.1(b) of the Directive requires that in such a situation a company must make a transfer, equal to the cost of the shares, from its distributable profits to a non-distributable reserve. This is to protect the interests of creditors by retaining funds within the company to cover the risk that the value of the shares may fall. Under the 1985 Act, as amended by the draft regulations, a company may purchase shares for holding in treasury only out of distributable profits. Accordingly, the cost of purchasing shares for holding in treasury would be debited to distributable profits. Consequently, a company would not record an asset that could be included in its balance sheet, and distributable reserves would be reduced. For these reasons, no provision is necessary to implement Article 22.1(b) in the draft regulations. An accounting treatment whereby treasury shares are deducted from reserves would reflect interpretation number 16 issued by the Standing Interpretations

Committee that has been adopted by the International Accounting Standards Board. However, there may be a risk that companies might claim that they could show treasury shares as assets, perhaps by "revaluing" them. If shares were "revalued" then paragraph 34 of Schedule 4 to the 1985 Act would require a non-distributable Revaluation Reserve to be established. It would be possible for the regulations to require that treasury shares may not be included as an asset in the balance sheet. Alternatively, this could be left to the Accounting Standards Board. Consultees' views on whether the regulations should require that treasury shares may not be included as an asset in the balance sheet would be welcomed.

Information to be included in the annual report

2.24 As pointed out in the previous consultative document, the Second Company Law Directive includes a number of requirements concerning the information to be included in companies' annual reports in respect of companies purchasing their own shares. These requirements have already been implemented (Part II of Schedule 7 to the 1985 Act) and were reproduced in paragraph 21 of Annex B of the previous consultative document. Views were sought on one possible further requirement, namely whether companies should be required to disclose their policy towards the acquisition, holding and sale of treasury shares. Views were split and no such requirement has been included in the draft regulations.

3 FURTHER ISSUES RAISED DURING THE PREVIOUS CONSULTATION (OR SUBSEQUENTLY) WHERE IT IS PROPOSED THAT COMPANY LAW BE AMENDED

Proceeds of a sale of treasury shares

3.1 New section 162F inserted by Regulation 3 of the draft regulations provides that the consideration received on a sale of treasury shares shall be treated as a profit for the purposes of Part VIII of the 1985 Act. However, as drafted, new section 162F does not specify whether the proceeds from the sale of treasury shares are realised or unrealised profit or a combination of both. That is to be left to professional guidance. At present, the accountancy bodies are revising their guidance on realised and unrealised profits. As an alternative, consideration could be given to amending section 162F to provide that only the proceeds from the sale of treasury shares up to the amount charged to distributable profits on purchase would be realised, with any excess (profit) being unrealised. It could further be required that any unrealised profit should be transferred to a designated reserve such as the Share Premium Account. Consultees' views on these alternatives would be welcomed. Consultees will wish to note that, under the proposals on the tax treatment of resales from treasury set out in section 6 and Annex D, any excess of proceeds over the amount paid on purchase would not be taxable. However, if such an excess were to increase distributable reserves, it might be necessary for the Government to consider whether any tax safeguards were required to prevent companies from exploiting the opportunity to generate a tax-free, but distributable, profit.

Register of members

3.2 Some respondents to the previous consultative document raised the issue of whether the holding of treasury shares needed to be reflected in a company's own register of members. The Department has concluded that, for reasons of transparency, the holding of shares in treasury should be recorded in the company's own register of members. Accordingly, the regulations provide that when a company holds treasury shares it will become a member of itself (as defined in section 22(2) of the 1985 Act) and be entered in the register of members. (Section 22(2) provides that "every person who agrees to become a member of the company, and whose name is entered in its register of members, is a member of the company".) This has been effected by new section 162A(1)(a) inserted by Regulation 3 and by the amendment of section 352 provided by paragraph 11 of the Schedule. Consultees should note that the requirement to enter treasury shares in the register of members applies only in respect any shares that are not cancelled forthwith after purchase. The register will not need to refer to the fact that the shares are treasury shares; the company's name will be entered as the registered holder of the shares in the same way as any other registered holder of shares. Consultees will also wish to note paragraphs 4.3 - 4.5 below dealing with the mechanism by which title to treasury shares is to be transferred. One

advantage of this approach (as opposed to the alternative of not including treasury shares in the register of members and maintaining a separate record of their holding) is that no amendments to the proposed Uncertificated Securities Regulations 2001 on which HM Treasury has recently consulted will be necessary, consequential to the treasury shares regulations. The proposed Uncertificated Securities Regulations 2001 will provide that registers of shares and members shall be divided into two parts, an issuer register (for certified securities) and an operator register (for uncertificated securities).

Notifications to Companies House - section 169 notices

3.3 Each time a company purchases its own shares it is required under section 169 of the 1985 Act to notify Companies House, within 28 days, of this fact on the prescribed form. The details required are the class, number and nominal value of the shares and the date(s) on which the shares were delivered to the company. In respect of public companies, section 169(2) requires that the aggregate amount paid and the minimum and maximum price paid in respect of shares of each class also have to be given. An additional provision has been included in the draft regulations (through the amendment of section 169 by paragraph 7 of the Schedule) so that companies will be required to indicate on a new, separate section 169(1B) notice all of the details referred to above in respect of section 169 notices for shares which they purchase and hold in treasury. Filing of the new section 169(1B) notice would, in general, be an alternative requirement to filing a section 169 notice. The only occasion when companies would have to file both would be where they purchased their own shares (which would have to be “qualifying shares” as defined in new section 162(4) inserted by Regulation 2 of the draft regulations), some of which were to be cancelled and some of which were to be held in treasury. Private companies which purchased their own shares and public companies which purchased non-qualifying shares would continue to be required to cancel those shares and file the existing section 169 notice. Companies will continue to be allowed 28 days to file section 169 notices. This would also be the period for filing the new section 169(1B) notices. As with the existing section 169 notice, a single section 169(1B) notice could be used for notifying Companies House of different purchases of shares as long as the company complied with the requirement to notify Companies House within 28 days.

3.4 The draft regulations include one further requirement (through the insertion of new section 169A by paragraph 8 of the Schedule). This provides that any company which was required to file the new 169(1B) notice indicating that some or all of its purchased shares were being held in treasury would be required to notify Companies House (through the new section 169A(2) notice) in the event that it subsequently cancelled or sold any of those treasury shares. (Without such a requirement there would appear to be little point in requiring companies, as proposed in paragraph 3.3 above, to indicate whether shares were being held in treasury following the initial purchase.) In the case of both cancellation and sale the notification would need to be made within 28

days and, in respect of each class of shares, would need to show the number and nominal value of the shares and the date on which they were cancelled or sold. It would thus mirror the present requirements of section 169(1) in respect of shares which are purchased for cancellation. By giving companies 28 days to make notifications they would be able to notify Companies House of sales (or cancellations) of treasury shares over a period of four weeks in one return.

3.5 Section 169(7) provides that a company which fails to notify Companies House of a repurchase of shares by not filing a section 169 notice (or which files a section 169 notice in which the details are incorrect or is late) is liable to a fine. Section 169(7) will also apply automatically to the new section 169(1B) notices. However, it would not apply to the new section 169A(2) notice and, therefore, a separate penalty for failing to file a section 169A(2) notice, or filing a section 169A(2) in which the details are incorrect or is late, has been provided for by section 169A(4) inserted by paragraph 8 of the Schedule. The penalties for transgression are set out in the amendment of Schedule 24 to the 1985 Act inserted by paragraph 18 of the Schedule to the draft regulations.

3.6 The Department would welcome comments on the proposals outlined in paragraphs 3.3 and 3.5 above. Consultees will also wish to note the reference to section 169 notices in paragraph 3.9 below under the heading “Bonus shares”.

Bonus shares

3.7 A number of consultees previously questioned what the position would be in respect of bonus shares. The Department considers that treasury shares should attract any fully paid bonus shares that a company issues in the same way that shares held by shareholders would attract fully paid bonus shares since, unlike a rights issue, bonus shares do not involve the exercise of a right. Moreover, without such a provision, the proportion of treasury shares held by a company would otherwise be diluted. The draft regulations provide (new section 162C(5) inserted by Regulation 3) that treasury shares, like other shares, attract fully paid bonus shares.

3.8 The regulations provide that bonus shares issued in respect of treasury shares will themselves be treated as if they were treasury shares and will need to be notified in a company’s register of members in the same way as is proposed (in new section 162A(1)(a) inserted by Regulation 3) for treasury shares resulting from a purchase of its own shares. The registering of bonus shares attached to treasury shares in a company’s register of members is provided for by the combination of new sections 162C(5) and 162A(1)(a).

3.9 An issue of bonus shares already needs to be notified to Companies House under section 88 of the 1985 Act which requires details of all new allotments of shares to be filed with Companies House. The combined effect of the proposed new sections 162C(5) and 169(1B) will be to require that any bonus shares issued in respect of treasury shares and which themselves

“become” treasury shares will need to be notified to Companies House on the new section 169(1B) notice. In the event of such treasury (bonus) shares being subsequently sold or cancelled, a section 169A(2) notice will need to be filed with Companies House. The Department accepts that if a notification to Companies House of bonus shares attached to treasury shares is to be made, amending section 88 and providing for a new or amended section 88 notice to be filed at Companies House might, at first glance, appear to be the most logical step. However, there would then be no mechanism for notifying Companies House of the subsequent sale or cancellation of such treasury (bonus) shares. Consultees’ views on the approach proposed by the Department would be welcomed. Consultees should note that the requirement to file a section 88 notice with Companies House remains unaltered: a section 88 notice indicating an issue of bonus shares would need to include any bonus shares that were issued into treasury. Section 88 notices currently require the details of allottees, and of the shares allotted to them, to be indicated on the reverse of the notices. In respect of bonus treasury shares the company would need to be indicated. Consultees should also note that sales of treasury shares are not to be regarded as allotments and, accordingly, a section 88 notice should not be filed at Companies House in respect of such sales.

Takeover offers

3.10 Some respondents to the previous consultative document questioned whether permitting treasury shares would affect the compulsory takeover provisions in the 1985 Act. Sections 428-430F provide that when an offeror makes an offer and acquires or contracts to acquire at least 90% of the shares under offer, he has the right to purchase the remaining 10% of the shares. Conversely, the minority shareholder also has the right to require his shares to be purchased by the offeror once the 90% threshold has been reached. There is, therefore, a question of whether, in determining the 90% threshold, it is fair to the offeror to include treasury shares (which would be the case if no amendment to the compulsory takeover provisions were made) since, if the company was holding 10% of the issued share capital in treasury, the 90% threshold would effectively be increased.

3.11 The draft regulations provide (through the amendment of sections 429 and 430A inserted by, respectively, paragraphs 12 and 13 of the Schedule) that the 90% threshold does not include treasury shares, ie once an offeror has acquired 90% of the offeree's non-treasury shares he has the right to acquire all remaining shares, including treasury shares (and, conversely, that minority shareholders have the right to have their shares purchased). The draft regulations also provide (new section 162D(2) inserted by Regulation 3) that once the 90% threshold has been reached and the company has been notified of that fact by the offeror, subsequent sales of the same class of shares from treasury by the company are prohibited (other than to the offeror). Comments from consultees on both the proposed policy set out above and the draft regulations implementing it would be welcomed.

4 OTHER ISSUES WHERE THE VIEWS OF CONSULTEES ARE SOUGHT BUT WHERE THE DRAFT REGULATIONS DO NOT INCLUDE ANY CHANGE TO COMPANY LAW

Nominees

4.1 Consultees will note that no mention is made in the draft regulations of the ability or otherwise of companies' treasury shares to be held by nominees. Some consultees may take the view that since company law generally permits the holding of shares by nominees, there is no reason why the draft regulations should depart from this principle in respect of treasury shares and which would otherwise deny companies some useful additional flexibility. Other consultees may consider that permitting companies to hold treasury shares through a nominee will result in it being more difficult to ensure compliance with the regulations (eg the requirement that companies may not hold more than 10% of their shares in treasury) and that, as a result, the system will be more open to abuse. Such consultees may also consider that permitting companies to hold treasury shares through a nominee will result in less transparency. It will be more difficult to ascertain in both annual returns filed at Companies House and in the register of members held by companies that such shares are indeed treasury shares held by the company rather than shares held by an ordinary registered shareholder.

4.2 Consultees' views would be welcomed. If it is decided that the holding of treasury shares by nominees is to be permitted, it should be noted that the regulations may need to be amended to incorporate provisions to the effect that any restrictions or obligations which apply in relation to the holding of treasury shares will apply equally to the holding through the nominee. If it is decided that the holding of treasury shares by nominees is not to be permitted, an express prohibition will be included in the regulations.

Mechanism by which title to treasury shares is to be transferred

4.3 Another issue that has been raised with the Department is the mechanism by which title to treasury shares is to be transferred. At present, when a company purchases its own shares, no proper instrument of transfer is required and there is no execution of a share transfer as the shares are treated as cancelled on purchase. However, given that the regulations provide that the company is to be regarded as a member of itself when holding treasury shares, the mechanism by which title to treasury shares is to be transferred from the shareholder to the company and then subsequently from the company to the new shareholder will be the same as if shares were being transferred from one shareholder to another. Accordingly, the draft regulations include no references to the transfer of title to treasury shares.

4.4 It may be worth pointing out that the 1985 Act provides very little in respect of the mechanism by which title to shares is to be transferred. The 1985 Act concentrates instead on establishing who is to be considered a

member of the company. The process of becoming (or ceasing to be) a member and shareholder is incomplete until entry on the company's register, and section 183(1) of the 1985 Act provides that it is not lawful for a company to register a transfer of shares unless a proper instrument of transfer has been delivered to it. (However, this is without prejudice to any power of the company to register as a shareholder a person to whom shares in the company have been transmitted by operation of law.) Consultees should note the requirement in new section 162A(1)(a) inserted by Regulation 3 that companies holding shares in treasury must enter the particulars in the company's register of members required by section 352. This is spelled out in more detail in paragraph 3.2 above dealing with companies' own register of members.

4.5 Consultees' views on whether the draft regulations need to provide for anything further would be welcomed.

Selling treasury shares at a discount and selling treasury shares for non-cash considerations

4.6 Section 100 of the 1985 Act provides that a company's shares shall not be allotted at a discount, ie that shares may not be allotted at a price which is less than their nominal, or par, value. Section 100 also provides that if shares are allotted in contravention of this requirement the allottee is liable to pay the company an amount equal to the amount of the discount, with interest at the appropriate rate. It would seem unlikely that a company would consider selling treasury shares at a discount to the nominal or par value of the shares given the typically low par value of shares. Moreover, the reasons why such a provision is necessary in relation to the allotment of new shares do not pertain to a **sale** of existing fully paid shares. Accordingly, no prohibition against selling at such a discount has been included in the draft regulations. However, consultees' views on whether such a prohibition is either necessary or desirable would be welcomed.

4.7 Consultees will also note that the regulations permit treasury shares to be sold either for a cash or non-cash consideration. This is intended to provide companies with the greatest flexibility and would, for example, permit a company to utilise shares held in treasury where it is the offeror in a proposed takeover. In view of the fact that only fully paid shares may be repurchased (see section 159(3) of the 1985 Act) and that it is proposed that a repurchase of shares that are to be held in treasury may only be funded out of distributable profits, it does not appear to the Department that it is necessary to apply provisions similar to section 103 of the 1985 Act to a sale of treasury shares. (Section 103 requires non-cash considerations to be valued before a company may allot shares.) Do consultees agree with this approach? It should be noted that if a prohibition on selling treasury shares at less than the nominal value were to be introduced, the value of any non-cash consideration would need to be determined (and provisions similar to those in section 103 of the 1985 Act would need to be included in the regulations) in order to ensure that treasury shares were not sold below their nominal value.

Redeemable shares

4.8 The draft regulations require that shares must be “qualifying shares” in order to be held in treasury but, beyond that, do not lay down any further requirements in respect of their type. Accordingly, companies would not be prohibited by the regulations from purchasing and holding in treasury for possible resale redeemable shares. The only caveat would be that redeemable shares could not be held in treasury beyond their date of redemption; at that stage they would have to be cancelled. Are consultees content with this approach?

Company charges

4.9 Another issue that was raised with the Department was whether companies should be entitled to grant a charge (either fixed or floating) over treasury shares. If a fixed charge over treasury shares were to be granted, this could, at least in theory, conflict with the rights of existing shareholders which would be conferred on them by pre-emption rights applying to sales of treasury shares.

4.10 Any prohibition on a fixed charge being granted over treasury shares (or a prohibition that a floating charge could not apply to treasury shares) would tend to go beyond the present parameters of the 1985 Act. In general, the 1985 Act deals only with the registration of charges created by companies and section 150 of the 1985 Act provides that, subject to a few exceptions, a lien or other charge of a public company on its own shares shall be void. This is aimed at a situation where a company is granted a charge on its own shares held by a third party to secure a debt or obligation owed by the third party to the company.

4.11 Consultees’ views would be welcomed on whether either of the following should be introduced:-

- i) a prohibition against a charge being granted over treasury shares; or
- ii) in the absence of a prohibition, a requirement for a company to offer to sell its treasury shares to shareholders before a charge could be granted.

Alternatively, should the draft regulations make no such provision?

Disclosure of interest in shares

4.12 Under Part VI of the 1985 Act (sections 198 - 220) there is a requirement for anyone with an interest in a company's shares to declare that interest when his shareholding reaches 3% (or in certain cases 10%) of the issued share capital and at each percentage point thereafter as the

shareholding increases or subsequently decreases. Issued share capital or "relevant share capital" as it is defined in section 198(2) of the 1985 Act means the company's issued share capital of a class that carries rights to vote in all circumstances at general meetings of the company. The definition of relevant share capital in section 198(2) includes treasury shares despite the fact that such shares would not attract voting rights. This is on the grounds that the voting rights of shares when they are held in treasury are suspended rather than revoked and therefore are still shares of a class that carry rights to votes (section 198(2)(b)). Accordingly, as is currently the case, it will not be until the relevant share capital decreases (following cancellation of the treasury shares) that there could become a requirement for notification to the company following a change in the level of shareholding by a shareholder, ie the present notification requirements would not be affected by the ability of a company to hold treasury shares. The draft regulations do not, therefore, include any amendments to Part VI of the 1985 Act. Do consultees agree with this analysis and that no amendment to Part VI needs to be made?

Arrangements and reconstructions

4.13 Sections 425 - 427A in Part XIII of the 1985 Act deal with arrangements and reconstructions. Section 425 creates a power for a company to enter into a compromise or arrangement with its creditors and/or members subject to sanction by the court. Where a compromise or arrangement is proposed between a company and its creditors or members and is agreed by a majority in number representing 75% in value of the creditors or shareholders present and voting at the relevant meeting(s) and is sanctioned by the court, it becomes binding on all creditors or members and on the company. The terms "compromise" and "arrangement" are not defined in the 1985 Act (other than the latter includes a reorganisation of a company's share capital) and the courts have construed "arrangement" as covering almost every type of legal transaction as long as there is some element of give and take. Reconstructions include mergers and amalgamations.

4.14 It does not appear to the Department that any amendments need to be made to Part XIII of the 1985 Act as a consequence of companies being permitted to hold treasury shares. It is clear, for example, that references to "share capital" in Part XIII include treasury shares. Moreover, if a company proposing to enter into an arrangement or reconstruction anticipated that treasury shares might cause a problem it would be open to that company to cancel the treasury shares before embarking on the exercise.

4.15 The draft regulations do not therefore include any amendments to Part XIII. However, the Department would welcome comments from consultees on this issue, particularly if they consider that the existence of treasury shares might pose an obstacle to companies wishing to enter into a compromise or arrangement under Part XIII. If so, it is possible that the regulations could be amended to apply for the different application of Part XIII in certain circumstances. The alternative of providing that no arrangement or

compromise under Part XIII could be proposed whilst a company held any shares in treasury or, possibly, that in the event of any such arrangement or compromise being proposed (or agreed) any treasury shares were deemed to be cancelled would appear, at first sight, to be overly prescriptive.

Employee share schemes

4.16 Consultees will note that there is no reference in the draft regulations to employee share schemes or to shares being held on behalf of employees. Accordingly, there would be no restrictions on companies holding shares in treasury as part of an employee share scheme, or shares being transferred from treasury to employees (who would then become the owner of the shares), for example where the employees were exercising share options, as long as the company complied with all other requirements applying to treasury shares.

4.17 Consultees' views on the use of treasury shares for the purposes of employee share schemes or being held in order to satisfy share options or share awards would be welcomed. In particular, do consultees consider that any provisions need to be introduced or restrictions lifted to facilitate the use of treasury shares in this way? EC law requires the voting rights of treasury shares to be suspended so this requirement could not be disapplied or varied. In commenting on the previous consultative document, some consultees said that, if treasury shares were to be utilised for an employee shares scheme, such shares would need to be ring fenced from other treasury shares in order to ensure that the company could not sell or cancel the shares without the agreement of the employees.

Notifications to Companies House - annual returns

4.18 Companies are required to make an annual return to Companies House and section 364A of the 1985 Act requires, amongst other things, the number of shares of each class held by each member to be indicated. Any company holding treasury shares would therefore be required, without a change to the 1985 Act (or to the annual return form), to indicate itself in the annual return as a member and the holder of those shares held in treasury. Accordingly, the draft regulations do not include any changes in respect of annual returns. Do consultees agree with this approach?

5 MINOR PROPOSED CONSEQUENTIAL CHANGES TO COMPANY LAW

Alteration of a company's objects

5.1 Section 5 of the 1985 Act provides that where a company's objects have been altered by special resolution, application may be made to the court for the alteration to be cancelled. In respect of a company limited by shares, an application may be made by the shareholders if they hold not less, in total, than 15% of the nominal value of the company's issued share capital or any class of it. Paragraph 1 of the Schedule to the draft regulations amends section 5 by providing that the reference to 15% excludes any treasury shares.

Minimum membership for carrying on business

5.2 Section 24 of the 1985 Act provides that any public company that carries on business without at least two members and does so for more than six months is liable, along with the member, for the payment of the company's debts contracted during that period. Paragraph 2 of the Schedule to the draft regulations amends section 24 so that the reference to "two members" does not include the company where it is holding treasury shares, ie that the reference to "two members" will continue to mean two "ordinary" shareholders.

Variation of class rights

5.3 Section 125(2) of the 1985 Act provides that where rights are attached to a class of shares otherwise than by the company's memorandum, and the company's articles do not contain provision with respect to the variations of the rights, those rights may be varied but only if:-

- i) the holders of three quarters in nominal value of the issued shares of that class consent in writing to the variation; or
- ii) an extraordinary resolution passed at a separate general meeting of the holders of that class sanctions the variation.

5.4 Paragraph 5(2) of the Schedule to the draft regulations amends section 125(2)(a) to provide that the reference to three quarters in nominal value of the issued shares excludes any treasury shares. However, in the event that there was agreement to such a variation of class rights, shares held in treasury would be varied in the same way as all other shares of that class. Although rights in treasury shares would be suspended, without the amendment proposed above the percentage needed for agreement to a variation in class rights would effectively be increased to a figure higher than 75% where a company held shares in treasury. A variation of rights via an extraordinary resolution under section 125(2)(b) is not affected by the holding of treasury shares and, accordingly, this section is not amended.

5.5 Section 125(5) of the 1985 Act provides that where rights are attached to a class of shares by the company's memorandum, and where the memorandum or articles do not contain provision with respect to the variations of the rights, those rights may be varied if all the members of the company agree to the variation. Paragraph 5(3) of the Schedule to the draft regulations provides that the reference to "all the members" does not include the company itself where it is holding treasury shares.

5.6 Section 125(6)(a) of the 1985 Act provides that in the event of a meeting being called to discuss a variation of class rights the necessary quorum shall be two persons holding, or representing by proxy, at least one third in nominal value of the shares of the class in question. (In the case of an adjourned meeting a quorum is one person holding shares of the class in question or his proxy.) Paragraph 5(4) of the Schedule to the draft regulations amends section 125(6)(a) to provide that the reference to one third of the nominal value of shares excludes any treasury shares. The general disapplication of rights that would otherwise apply to treasury shares provided by section 162C(2) inserted by Regulation 3 of the draft regulations means that the above reference to one person (in respect of an adjourned meeting) could not be the company if it held treasury shares.

Merger relief and merger accounting

5.7 Section 131 of the 1985 Act applies where an "issuing" company has secured at least a 90% equity holding in another company in pursuance of an arrangement providing for the allotment of equity shares in the issuing company on terms that the consideration for the shares allotted is to be provided:-

- i) by the issue or transfer to the issuing company of equity shares in the other company; or
- ii) by the cancellation of any such shares not held by the issuing company.

5.8 Paragraph 6 of the Schedule to the draft regulations amends section 131 by providing that the reference to the 90% equity holding excludes any treasury shares.

Capital redemption reserve

5.9 Section 170 of the 1985 Act provides that where a company's shares are redeemed or purchased wholly out of the company's profits, the amount by which the company's issued share capital is diminished on cancellation of the shares redeemed or purchased is to be transferred to a reserve, called the "capital redemption reserve". Paragraph 9 of the Schedule to the draft regulations amends section 170 so that it also applies to the cancellation of treasury shares.

Definition of connected persons etc

5.10 Section 346 of the 1985 Act sets out definitions in respect of a person being “connected” with a director of a company, and to a director being “associated with” or “controlling” a body corporate. Section 346(4)(a) provides that a director of a company is associated with a body corporate if he has an interest in at least one-fifth of the nominal value of that body corporate’s equity share capital. Section 346(5)(b) provides that a director of a company is deemed to control a body corporate if he and the other directors of the company have an interest in more than one-half of that body corporate’s equity share capital. Paragraph 10 of the Schedule to the draft regulations amends sections 346(4)(a) and 346(5)(b) by providing that the references to, respectively, one-fifth and one-half of the equity share capital exclude any treasury shares.

Investigation of a company

5.11 Section 431 of the 1985 Act provides that the Secretary of State may appoint inspectors to investigate the affairs of a company and to report on them. In the case of a company having a share capital, the appointment may be made on the application of not less than 200 members or of members not holding less than one-tenth of the shares issued. Paragraph 14 of the Schedule to the draft regulations amends section 431 so that the reference to one-tenth of the shares issued excludes any treasury shares.

Index of defined expressions

5.12 Section 744A of the 1985 Act sets out an index of defined expressions and the section numbers in the 1985 Act in which the expressions are defined. Paragraph 15 of the Schedule to the draft regulations adds “treasury shares” and “section 162A(2)” to the index. The definition of treasury shares is set out in new section 162A(2) inserted by Regulation 3 of the draft regulations.

Form and content of company accounts

5.13 Schedule 4 to the 1985 Act deals with the form and content of company accounts, and section B of Part I sets out balance sheet formats. Paragraph 16 of the Schedule to the draft regulations amends note 4 of section B of Part I in respect of the holding of own shares. It clarifies that own shares that have a book value need not necessarily be shown as an asset in a company's balance sheet; for example own shares held via certain employee share schemes. This clarification is likely to assist in international harmonisation of accounting treatments.

Form and content of group accounts

5.14 Schedule 4A to the 1985 Act deals with the form and content of group accounts. Paragraph 10(1) of Schedule 4A sets out the conditions for

accounting for an acquisition as a merger, and paragraph 10(1)(a) states that one of those conditions is that at least 90% of the nominal value of the relevant shares in the undertaking acquired is held by or on behalf of the parent company and its subsidiary undertakings. In this context, “relevant shares” means those carrying unrestricted rights to participate both in distributions and in the assets of the undertaking upon liquidation. Paragraph 17 of the Schedule to the draft regulations amends paragraph 10 of Schedule 4A to the 1985 Act by providing that the reference to 90% of the nominal value of the relevant shares excludes any treasury shares held by the undertaking.

6 TAX CONSEQUENCES OF PROPOSED COMPANY LAW CHANGES

6.1 The Government is also considering the tax treatment in respect of the holding of shares in treasury. The aim is to complement the changes to company law by achieving the fairest and most efficient tax treatment whilst not adding undue complexity to the tax system.

6.2 The tax issues divide into three broad categories:-

- i) the taxation of the shareholder when shares are repurchased;
- ii) the status of the shares while held in treasury by the company;
- iii) the treatment of sales of shares from treasury.

6.3 The Government proposes to treat purchases without cancellation in broadly the same way as purchases with cancellation for tax purposes. The Government considers that these essentially similar transactions should be taxed in the same way. Moreover, once company law has been amended to allow shares to be held in treasury, it will not be practical to draw a distinction for tax purposes between purchases without cancellation of the shares and purchases followed by cancellation.

6.4 The tax issues are set out in more detail at Annex D but, in broad terms, the Government proposes the following approach:-

- i) shareholders would be taxed on the proceeds of a repurchase in the same way, whether or not the shares were subsequently cancelled;
- ii) shares held in treasury would be treated **as though** they had been cancelled. Accordingly, they would be excluded from the company's issued share capital for tax purposes and would be disregarded when applying tests based on a percentage of issued share capital;
- iii) sales of shares from treasury would be treated in broadly the same way as a new issue of shares. This would mean that the sale would not give rise to a chargeable gain or an allowable loss in the hands of the company. In addition, stamp duty would not be chargeable on a sale from treasury. However, the Inland Revenue will wish to consider the position for some reliefs dependent on shares being newly issued, for example in the context of Venture Capital Trusts.

6.5 Comments are invited on any aspect of this approach. It is expected that Finance Bill legislation dealing with the tax consequences will be introduced at the first opportunity after the regulations amending company law have been laid, and that the changes to tax law and company law will take effect from the same date.

SUMMARY OF QUESTIONS

Q1 Have you any comments on the draft Regulatory Impact Assessment (RIA) at Annex E? In particular, what are your estimates of the savings or other benefits (or any costs) that would be expected to result from the proposed regulations? Paragraph 6 of the RIA sets out the comments that were previously received on savings. Comments are also sought on the regulatory impact of the proposed tax treatment. (Paragraph 1.7 of the consultative document.)

Q2 Do you consider that there is likely to be any demand to finance the purchase of shares for holding in treasury from the proceeds of a fresh issue of shares and, if so, should this option be included in the regulations? If yes, what are your views on the treatment of the proceeds of a sale of any treasury shares financed from the proceeds of a fresh issue of shares and on the additional requirements identified in i) - iii) of paragraph 2.5. Under the draft regulations, a purchase of shares for holding in treasury could be financed only out of distributable profits. Shares which are purchased for immediate cancellation could continue to be financed out of the proceeds of a fresh issue of shares. (Paragraph 2.5.)

Q3 What are your views on the proposal that investment companies should be prevented from holding treasury shares? (Paragraph 2.7.)

Q4 What are your views on including a requirement in the regulations that treasury shares may not be included as an asset in the balance sheet? (Paragraph 2.23.)

Q5 The draft regulations provide that the consideration received on a sale of treasury shares shall be treated as a profit (although the regulations do not specify whether such profit would be realised or unrealised or a combination of both). What are your views on the regulations providing instead that only the proceeds from a sale of treasury shares up to the amount charged on purchase would be realised, with any excess (profit) being unrealised? Should any unrealised profit be required to be transferred to a designated reserve such as the Share Premium Account? (Paragraph 3.1.)

Q6 What are your views on the proposed requirements concerning the recording of treasury shares in companies' own registers? (Paragraph 3.2.)

Q7 What are your views on the proposed modifications to section 169 notices for companies notifying Companies House of purchases of their own shares, the holding of such shares in treasury and their subsequent sale or cancellation? (Paragraphs 3.3 - 3.6.)

Q8 Do you have any comments on the proposed treatment of bonus shares? (Paragraphs 3.7 - 3.9.)

Q9 What are your views on the proposed changes to the compulsory purchase provisions in Part XIII A of the 1985 Act in respect of takeovers? (Paragraphs 3.10 - 3.11.)

Q10 Do you have any comments on whether or not it should be permitted for companies' treasury shares to be held by nominees? (Paragraphs 4.1 - 4.2.)

Q11 Do you have any comments on the fact that, because a company holding treasury shares will be regarded as a member of itself, the regulations include no references to the transfer of title to treasury shares? (Paragraphs 4.3 - 4.5.)

Q12 What are your views on including a provision prohibiting treasury shares being sold at a discount to their nominal, or par, value? (Paragraph 4.6.)

Q13 Do you have any comments on the proposal that sales of treasury shares should not be restricted to sales for cash? (Paragraph 4.7.)

Q14 Do you have any comments on whether it should be prohibited to hold redeemable shares in treasury? It would not be permitted to hold redeemable shares in treasury past their date of redemption. (Paragraph 4.8.)

Q15 Do you consider that companies should be entitled to grant a charge, either fixed or floating, over treasury shares or should this be prohibited? Alternatively, in the absence of a prohibition, should a requirement be introduced for a company to offer to sell its treasury shares to shareholders before a charge could be granted? (Paragraphs 4.9 - 4.11.)

Q16 Do you agree with the Department's analysis that no amendments to Part VI of the 1985 Act dealing with disclosure of interest in shares need to be made? (Paragraph 4.12.)

Q17 Do you agree with the Department's analysis that no amendments to Part XIII of the 1985 Act dealing with arrangements and reconstructions need to be made? (Paragraphs 4.13 - 4.15.)

Q18 Do you have any comments on treasury shares being used for employee share schemes or being held in order to satisfy share options or share awards? In particular, do you consider that any provisions need to be introduced or restrictions lifted to facilitate the use of treasury shares in this way? (Paragraphs 4.16 - 4.17)

Q19 Do you agree with the Department's analysis that no amendments to section 364A of the 1985 Act dealing with the annual return filed at Companies House need to be made? (Paragraph 4.18)

Q20 Do you have any comments on any of the minor proposed consequential changes to company law dealing with:-

- i) alteration of a company's objects (paragraph 5.1);
- ii) minimum membership for carrying on business (paragraph 5.2);
- iii) variation of class rights (paragraphs 5.3 - 5.6);
- iv) merger relief and merger accounting (paragraphs 5.7 - 5.8);
- v) capital redemption reserve (paragraph 5.9);
- vi) definition of connected persons etc (paragraph 5.10);
- vii) investigation of a company (paragraph 5.11);
- viii) index of defined expressions (paragraph 5.12);
- ix) form and content of company accounts (paragraph 5.13);
- x) form and content of group accounts (paragraph 5.14).

Q21 Do you have any comments on any other company law issue raised in the consultative document? Do you have any comments on any company law issue not covered in the consultative document? Do you have any comments on the draft regulations?

Q22 Do you have any comments on whether the current tax treatment of share repurchases should be extended to purchases without cancellation or on any practical issues which need to be considered? (Paragraphs 7 - 9 of Annex D.)

Q23 Do you have any views on the proposal that treasury shares should be excluded from issued share capital for tax purposes, and should also be disregarded when applying tests based on a percentage of issued share capital? (Paragraphs 10 - 11 of Annex D.)

Q24 Do you have any views on the proposed tax treatment of shares sold from treasury under which a sale of shares held in treasury after a purchase would not give rise to a capital gain or loss in the hands of the company selling the shares, and a sale of shares by a company from treasury would be regarded as an issue of shares for the purposes of reliefs such as capital gains rollover relief on a takeover? (Paragraphs 12 - 15 of Annex D.)

Q25 Do you have any comments on the proposed Stamp Duty treatment under which a purchase of shares without cancellation would be treated in the same way as a purchase followed by cancellation, and a sale from treasury would be treated like a new issue? (Paragraphs 16 - 17 of Annex D.)

22 December 1999

**PURCHASE BY COMPANIES OF THEIR OWN SHARES FOR HOLDING IN
TREASURY: KIM HOWELLS ANNOUNCES PROPOSED
CHANGE TO THE LAW**

Kim Howells, Parliamentary Under Secretary of State at the Department of Trade and Industry, announced today that he has decided to deregulate company law in respect of the holding of shares in treasury. His decision follows consultation on a possible change to the law undertaken by DTI. Further consultation will take place on the basis of draft regulations in the New Year. Dr Howells said:

"I have considered carefully the responses to my Department's consultative document. I have concluded that the present law should be amended to allow companies to purchase their own shares and hold them in treasury for resale at a later date. The present requirement that share purchases have to be approved by shareholders will continue. The maximum amount of shares that a company will be permitted to hold in treasury will be ten percent of its share capital and the voting rights of the shares will be suspended, in accordance with EU law. The change will give companies additional flexibility in managing their share capital and should help to reduce their cost of capital. I have also decided that the payment of dividends in respect of shares held in treasury should be suspended, and that sales of shares from treasury should be suspended at price sensitive times.

"I have considered the representations that have been made in respect of pre-emption rights and have concluded that the requirement under which pre-emption rights apply to sales of new shares should also apply to sales of shares from treasury. Accordingly, pre-emption rights would apply to sales of treasury shares unless shareholders had approved that they should not so apply. However, the wider issue of pre-emption rights is being considered by the independent Company Law Review and I look forward to seeing any recommendations from the Review in due course.

"It will be a matter for the Pre-emption Group, which has issued guidelines on the circumstances under which shareholders should agree to the disapplication of pre-emption rights to new share issues, to determine whether those guidelines should be extended to sales of treasury shares. The Group will no doubt consider the framework for disapplication which has been drawn up by the Association of Corporate Treasurers, Association of British Insurers and the National Association of Pension Funds.

"The next stage will be the publication for consultation of the draft amending legislation. It will set out the proposed rules that would apply in respect of such issues as shareholder approval and disclosure to the market as well as

the types of companies to which the relaxed regime will apply. In the light of comments made in response to the first consultative document, it will propose restricting the facility of treasury shares to companies which are listed on the London Stock Exchange or on another recognised investment exchange such as AIM. However, the further consultation will also provide another opportunity for unlisted companies to make out a case for being allowed to hold treasury shares. The draft amending legislation will also provide that investment companies should not be permitted to hold shares in treasury. The responses to the first consultative document pointed to not allowing subsidiaries, in general, to purchase, hold in treasury and resell their parent company's shares and the next consultative document will reflect that view.

NOTES FOR EDITORS

Under the present law - the Companies Act 1985 - companies are permitted to purchase their own shares. However, it is a requirement that, on purchase, the shares must be cancelled. This condition was introduced in 1981: prior to that time companies were not permitted to purchase their own shares.

A consultative document entitled "Share Buybacks" was issued by DTI in May 1998 inviting views on the proposal that companies should be permitted to purchase and hold in treasury for subsequent resale up to 10% of their issued share capital, as permitted by the Second EC Company Law Directive. The right to vote attaching to any shares held in treasury would be suspended in line with the Directive. The consultative document also sought comments on a number of other possible requirements. A summary of responses was issued in October 1998.

Pre-emption rights are rights of existing investors to be offered the first opportunity to purchase any new shares issued by a company in proportion to their existing shareholding. Such rights are given to existing shareholders under the Companies Act 1985. However, under the Act, shareholders may agree to dispense with or modify the right of pre-emption. In practice, shareholders appear to agree, routinely, that a company may issue up to 5% of shares on a non-pre-emption basis in any one year.

The Pre-emption Guidelines were introduced in 1988 by the Pre-emption Group which comprises representatives of listed companies, investment institutions and corporate finance practitioners. The Group was formed under the auspices of the London Stock Exchange and meets to monitor the operation of the Guidelines and to consider the continued need for such guidance. The guidelines make recommendations on the circumstances under which shareholders should agree to the disapplication of pre-emption rights to new share issues.

The issue of the consultative document was the subject of a previous press notice, P/98/355 issued on 7 May 1998.

DRAFT

 STATUTORY INSTRUMENTS

2002 No.

COMPANIES
**The Companies (Acquisition of Own Shares)
 (Treasury Shares) Regulations 2002**
Made2002*Laid Before Parliament*2002*Coming into force*.....2002

The Secretary of State, being a Minister designated^(a) for the purposes of section 2(2) of the European Communities Act 1972^(b) in relation to measures relating to the acquisition by companies of their own shares, and to distributions to their shareholders, in exercise of the powers conferred on her by section 2(2) of that Act and of all other powers enabling her in that behalf, hereby makes the following Regulations:

Citation, commencement and interpretation

1.-(1) These Regulations may be cited as the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2002 and shall come into force on [].

(2) In these Regulations, “the 1985 Act” means the Companies Act 1985^(c).

Amendment of section 162

2. -(1) Amend section 162 of the 1985 Act (power of company to purchase own shares) as follows.

(2) For subsection (2) substitute –

“(2) Sections 159 to 161 apply to the purchase by a company under this section of its own shares as they apply to the redemption of redeemable shares.

(a) S.I. 1999/654.

(b) 1972 c.68: as amended by the European Economic Area Act 1993 (c.51).

(c) 1985 c.6.

This is subject to subsections (2A) and (2B).

(2A) The terms and manner of a purchase under this section need not be determined by the articles as required by section 160(3).

(2B) Where a company (other than an investment company) makes a purchase of qualifying shares out of distributable profits under this section, section 162A applies to the shares purchased; and accordingly section 160(4) does not apply to those shares.”.

(3) At the end of subsection (3) insert “or shares held as treasury shares”.

(4) After subsection (3) insert the following subsection –

“(4) For the purposes of this section –

“investment company” has the same meaning as in section 266;

“qualifying shares” are shares-

(a) which have been included in the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000^(a), or

(b) are traded on the market known as the Alternative Investment Market established under the rules of The London Stock Exchange Limited, or

(c) are officially listed in an EEA State (other than the United Kingdom), or

(d) are traded on a market established in an EEA State (other than the United Kingdom) which is a regulated market for the purposes of Article 16 of Council Directive 93/22/EEC of 10 May 1993^(b) on investment services in the securities field.

Insertion of sections 162A, 162B, 162C, 162D, 162E and 162F

3. After section 162 of the 1985 Act insert the following sections-

“Treasury shares

162A.-(1) Where this section applies to shares purchased by a company out of distributable profits in accordance with section 162, the company may -

(a) hold the shares (or any of them) (in which event the particulars required by section 352 shall be entered in the company’s register of members in respect of the shares), or

(b) deal with any of them, at any time, in accordance with section 162D.

(2) In this Act, references to a company holding shares as treasury shares are references to the company holding shares which-

^(a) 2000 c.8.

^(b) OJ L 141, 11.6.93, p.27.

- (a) were (or are treated as having been) purchased by it in circumstances in which this section applies, and
- (b) have been held by the company continuously since they were so purchased.

Treasury shares: maximum holdings

162B.-(1) Where a company has shares of only one class, the aggregate nominal value of shares held as treasury shares must not at any time exceed ten per cent of the nominal value of the issued share capital of the company at that time.

(2) Where the share capital of a company is divided into shares of different classes, the aggregate nominal value of the shares of any class held as treasury shares must not at any time exceed ten per cent of the nominal value of the issued share capital of the shares in that class at that time.

(3) If at any time the aggregate nominal value of shares held by a company as treasury shares is such that it exceeds the limit specified in subsection (1) or, as the case may be, (2) above, section 160(4) shall have effect in relation to the excess shares as if they were redeemable shares redeemed under section 160 at the time the limit is exceeded.

For this purpose “the excess shares” means such number of the shares, held by the company as treasury shares at the time in question, as resulted in the limit being exceeded.

Treasury shares: voting and other rights

162C.-(1) This section applies to shares which are held by a company as treasury shares.

(2) The company must not exercise any rights (whether to attend or vote at meetings, or otherwise) in respect of treasury shares, and any purported exercise of any of those rights is void.

(3) No dividend may be paid, and no other distribution (whether in cash or otherwise) of the company’s assets (including any distribution of assets to members on a winding up) may be made to the company in respect of treasury shares.

(4) But the restriction in subsection (3) does not prevent-

- (a) a distribution by way of an allotment of shares as fully paid bonus shares in respect of treasury shares, or
- (b) the payment of any amount payable on the redemption of treasury shares (if they are redeemable shares).

(5) Any shares allotted as fully paid bonus shares in respect of treasury shares shall be treated for the purposes of this Act as if they were purchased by the company at the time they were allotted, in circumstances in which section 162A(1) applied.

Treasury shares: disposal and cancellation

162D.-(1) A company may at any time sell (for a cash or non-cash consideration) or cancel any shares which it holds as treasury shares.

(2) But if the company receives a notice under section 429 that a person desires to acquire any of the shares, the company must not sell the shares to which the notice relates except to that person.

(3) If the company cancels shares held as treasury shares, the company must diminish the amount of the issued share capital by the nominal value of the shares cancelled; but the cancellation is not to be taken as reducing the amount of the company's authorised share capital.

(4) The directors may take such steps as are requisite to enable the company to cancel its shares under subsection (1) without complying with sections 135 and 136 (resolution to reduce issued share capital; application to court for approval).

Treasury shares: mandatory cancellation

162E.-(1) If at any time when a company holds shares as treasury shares it becomes an investment company, section 160(4) shall have effect in relation to those shares as if they were redeemable shares redeemed under section 160 at the time the company becomes an investment company.

(2) If shares held as treasury shares cease to be qualifying shares, section 160(4) shall have effect in relation to those shares as if they were redeemable shares redeemed under section 160 at the time they cease to be qualifying shares.

(3) For the purposes of subsection (2), shares shall not be regarded as ceasing to be qualifying shares by virtue only of: the suspension of their listing in accordance with the applicable rules in the EEA State in which the shares are officially listed or; in the case of shares traded on the market known as the Alternative Investment Market, the suspension of their trading in accordance with the rules of the London Stock Exchange Limited or; in any other case, the suspension of their trading in accordance the rules of the regulated market on which they are traded.

(4) For the purposes of this section "investment company" and "qualifying shares" have the same meaning as in section 162.

Treasury shares: proceeds of sale

162F. Where shares held as treasury shares are sold the consideration received by the company shall be treated as a profit for the purposes of Part VIII."

Consequential amendments

4. The Schedule to these regulations (which contains consequential amendments) has effect.

2002

Melanie Johnson,
Parliamentary Under-Secretary
of State for Competition, Consumers and Markets,
Department of Trade and Industry

SCHEDULE

Amendment of section 5

1. In section 5 of the 1985 Act (procedure for objecting to alteration of company's objects) after subsection (7) insert –

“(7A) For the purposes of subsection (2)(a), any of the company's issued share capital held as treasury shares must be disregarded.”.

Amendment of section 24

2. In section 24 of the 1985 Act (minimum membership for carrying on business), the existing provision becomes subsection (1) of that section, and at the end insert –

“(2) For the purposes of this section references to a member of a company do not include the company itself where it is such a member only by virtue of its holding shares as treasury shares.”.

Amendment of section 89

3. In section 89 of the 1985 Act (offers to shareholders to be on pre-emptive basis) after subsection (5) insert -

“(6) For the purposes of subsections (1) and (2), shares held by a company as treasury shares are not “relevant shares”.”.

Amendment of section 94

4. In section 94 of the 1985 Act (definitions for sections 89-96), after subsection (3) insert-

“(3A) A reference to the allotment of equity securities or of equity securities consisting of relevant shares of a particular class also includes the sale of any relevant shares in the company or (as the case may be) relevant shares of a particular class if, immediately before the sale, the shares were held by the company as treasury shares.”.

Amendment of section 125

5.-(1) Amend section 125 of the 1985 Act (variation of class rights) as follows.

(2) In subsection (2)(a) after the word “class” insert the words “(excluding any shares of that class held as treasury shares)”.

(3) In subsection (5) after the word “company” insert the words “(excluding any member holding shares as treasury shares)”.

(4) In subsection (6)(a) after the word “question” where it first appears insert the words “(excluding any shares of that class held as treasury shares)”.

Amendment of section 131

6. In section 131 of the 1985 Act (merger relief)^(a), at the end of subsection (4) insert “(excluding any shares in that company held as treasury shares)”.

Amendment of section 169

7.-(1) Amend section 169 of the 1985 Act (disclosure by company of purchase of own shares)^(b) as follows.

(2) At the beginning of subsection (1) insert “Subject to subsection (1A)”.

(3) After subsection (1) insert the following subsections-

“(1A) In the case of a company which has purchased its own shares in circumstances in which section 162A applies, the requirement to deliver a return under subsection (1) shall only apply where some or all of the shares have been cancelled forthwith after the date of their delivery in accordance with sections 162B, 162D(1) or 162E and in those circumstances the particulars required by that subsection to be stated with respect to the shares purchased shall apply only to such of the shares as have been so cancelled.

(1B) Where a company has purchased its own shares in circumstances in which section 162A applies, the company shall within the period of 28 days beginning with the date on which such shares are delivered to it (except where such shares are cancelled forthwith after the date of their delivery in accordance with sections 162B, 162D(1) or 162E) deliver to the registrar of companies for registration a return in the prescribed form stating with respect to shares of each class purchased (other than shares which have been cancelled in the circumstances referred to in subsection (1A)) the number and nominal value of each of those shares which are held as treasury shares and the date on which they were delivered to the company.”.

(4) In subsection (2) for “the return” substitute “any return under subsection (1) or (1B)”.

(5) In subsection (3) after “return” insert “under either subsection (1) or (1B)”.

^(a) Section 131 was amended by section 439(1) of and Schedule 13 to the Insolvency Act 1986 (c.45) and section 145 of and Schedule 19 to the Companies Act 1989 (c.40).

^(b) Section 169 was amended by sections 143(2) and 212 of, and Schedule 24 to, the Companies Act 1989.

Insertion of section 169A

8. After section 169 of the 1985 Act insert the following section -

“Disclosure by company of cancellation or sale of treasury shares

169A. -(1) Subsection (2) applies in relation to any shares held by a company as treasury shares if-

(a) the company is or was required to make a return under section 169(1B) in relation to the shares, and

(b) the shares have-

- (i) been cancelled under section 162B, 162D or 162E or
- (ii) been sold under section 162D.

(2) Within the period of 28 days beginning with the date on which such shares are cancelled or sold, the company shall deliver to the registrar of companies for registration a return in the prescribed form stating with respect to shares of each class cancelled or sold-

- (a) the number and nominal value of those shares, and
- (b) the date on which they were cancelled or sold.

(3) Particulars of shares cancelled or sold on different dates may be included in a single return to the registrar.

(4) If default is made in delivering to the registrar any return required by this section, every officer of the company who is in default is liable to a fine and, for continued contravention, to a daily default fine.”.

Amendment of section 170

9. In section 170(1) of the 1985 Act (the capital redemption reserve) before the words “shall be transferred” insert “, or section 162D(3) on cancellation of shares held as treasury shares.”.

Amendment of section 346

10. In section 346 of the 1985 Act (“connected persons”, etc)-

- (a) at the end of subsection (4)(a) insert “(excluding any shares in the company held as treasury shares)”, and
- (b) in subsection (5)(b) after “that share capital” insert “(excluding any shares in the company held as treasury shares)”.

Amendment of section 352

11. In section 352 of the 1985 Act (obligation to keep and enter up register of members) after subsection (3) insert –

"(3A) Where a company purchases one or more of its own shares in circumstances in which section 162A applies-

(a) the requirements of subsection (2) and (3) must be complied with unless the company cancels all of the shares forthwith after the purchase in accordance with section 162B, 162D(1) or 162E, but

(b) any share which is so cancelled shall be disregarded for the purposes of subsection (3).".

Amendment of section 429

12. In section 429 of the 1985 Act (right of offeror to buy out minority shareholders)^(a)

(a) in subsection (1) before “he may” insert “(excluding any shares in the company held as treasury shares)”, and

(b) in subsection (2) before “, he may” insert “(excluding any shares in the company held as treasury shares)”.

Amendment of section 430A

13. In section 430A of the 1985 Act (right of minority shareholder to be bought out by offeror)^(b) -

(a) at the end of subsection (1)(b) insert “(excluding any shares in the company held as treasury shares)”, and

(b) at the end of subsection (2)(b) insert “(excluding any shares in the company held as treasury shares)”.

Amendment of section 431

14. In section 431 of the 1985 Act (investigation of a company on its own application or that of its members) at the end of subsection (2)(a) insert “(excluding any shares held as treasury shares)”.

^(a) Section 429 was substituted by section 172(1) of and Schedule 12 to the Financial Services Act 1986 (c.60).

^(b) Section 430A was substituted by section 172(1) of and Schedule 12 to the Financial Services Act 1986.

Amendment of Schedule 24

18. In Schedule 24 to the 1985 Act (punishment of offences under the 1985 Act)^(a) at the appropriate place in the Table insert-

“169A(4)	Default by company’s officer in delivering to registrar the return required by section 169A (disclosure by company of cancellation or sale of treasury shares)	1. On indictment	A fine	One-tenth of the statutory maximum.”.
		2. Summary	The statutory maximum	

^(a) Schedule 24 has been variously amended in a manner not relevant to these Regulations.

DETAILS OF PROPOSED TAX TREATMENT

Treatment of shareholder on a purchase of shares into treasury

Current tax treatment of a repurchase of shares

In principle, when a company purchases its own shares, part of the proceeds received by the shareholder is a distribution of the company's profit. The shareholder is generally subject to income tax on this distribution, as though it were a dividend. This is consistent with the fact that, in accounting terms, purchases of shares are generally funded from distributable profits.

2 The amount of the distribution, for tax purposes, is calculated by deducting the price paid to the company when the shares were originally issued (which will frequently not be the price paid by the shareholder who is selling the shares back to the company). For example:-

Proceeds of purchase of shares	1000
Less price paid to the company on issue	<u>100</u>
Distribution	<u>900</u>
Amount chargeable to Income Tax:	
Distribution	900
Plus tax credit	<u>100</u>
	<u>1000</u>
Income Tax due:	
Individual within basic rate band	
1000 @ 10%	100
Less tax credit	<u>100</u>
	<u>Nil</u>
Individual liable at higher rates	
1000 @ 32.5%	325
Less tax credit	<u>100</u>
	<u>225</u>

3 The amount corresponding to the original issue price is treated as a repayment of share capital, and this amount is treated as the proceeds of the disposal of the shares for Capital Gains Tax purposes (which will generally produce a capital loss).

4 If the shareholder had sold the shares to a third party there would be no income distribution. Instead, the whole of the proceeds would be brought into the Capital Gains Tax computation. This wholly capital treatment also applies where (as is frequently the case) a repurchase of shares is carried out through

the market with a market-maker acting as intermediary principal. In practice, therefore, a disposal by a shareholder will often be wholly within the scope of Capital Gains Tax rather than Income Tax, even where the shares are ultimately purchased by the company itself.

5 The examples given above involve individual shareholders. However, for most other categories of shareholders there is in practice no difference in tax treatment between a sale back to the company and a sale to a third party. For example, the majority of quoted shares are held by exempt institutions for which the tax treatment is irrelevant. For UK corporate shareholders there is in practice no difference, because distributions are not subject to Corporation Tax (section 208 of the Income and Corporation Taxes Act) and the whole of the proceeds from a repurchase of shares are included in the computation of the capital gain (Inland Revenue Statement of Practice 4/89).

6 There are special rules for repurchases by unquoted companies (including companies traded on AIM) in sections 219-229 of the Income and Corporation Taxes Act. Provided certain conditions are met, repurchases of shares by these companies are not treated as an income distribution and the tax consequences for the shareholder are exactly the same as for a sale to a third party. The conditions include an avoidance test and there is a procedure for advance clearance.

Taxation of a purchase of shares into treasury

7 The Government proposes that the tax treatment of a shareholder should be the same, whether or not the shares are subsequently cancelled or are held in treasury. This would seem to be a practical necessity, because it may not be clear at the time of the share repurchase whether the shares are subsequently going to be cancelled. It is also possible that a proportion of the shares purchased may be cancelled with the remainder being held in treasury.

8 The most straightforward way to achieve this result would be to extend the existing treatment of share repurchases to the proposed new facility, ie a purchase without cancellation. In order to obtain full alignment it would be necessary to treat any shares bought into treasury as though they were being cancelled. Otherwise, the whole proceeds of the purchase would be treated as an income distribution, without deduction of the original issue price.

9 It seems right in principle to treat a purchase of shares into treasury as (at least in part) an income distribution, as such purchases will be made from distributable profits. In practice, however, it is expected that many repurchases would continue to be carried out through the market (that is, with a market-maker as intermediary principal between the company and the shareholder). Accordingly, in many cases individual shareholders would continue to be wholly within the scope of Capital Gains Tax rather than Income Tax. Comments are invited:-

- i) on whether the current tax treatment of share repurchases should be extended to purchases without cancellation;
- ii) on any practical issues which need to be considered.

Treatment of shares held in treasury

10 It is proposed that shares held in treasury should be excluded from the company's issued share capital for tax purposes. Although the shares will continue to form part of the company's issued share capital for company law purposes, the rights attached to the shares for company law purposes will be suspended, so it would seem appropriate to disregard them. It is also consistent with the treatment of a sale from treasury as though it were a new issue.

11 Views are invited on the proposal that treasury shares should be excluded from issued share capital for tax purposes, and should also be disregarded when applying tests based on a percentage of issued share capital.

Treatment of shares sold from treasury

12 Under current law, when a company purchases its own shares, cancels them and later issues new shares, there are no direct Corporation Tax implications for the company itself. If the value of the shares has risen or fallen between the purchase and the new issue, this does not generate a capital gain or loss in the hands of the company. It is proposed that a similar treatment should be applied on a purchase without cancellation followed by a sale of the shares from treasury, ie that a sale of shares held in treasury after a purchase should not give rise to a capital gain or loss in the hands of the company selling the shares.

13 There are a number of other questions which arise in relation to sales of shares from treasury, notably whether a sale will be regarded as an issue of shares for the purposes of various reliefs available to shareholders which are dependent on the issue of shares. Broadly, it is proposed that reliefs allowing capital gains to be 'rolled over' into new shares should be available on a sale from treasury in the same way as on a new issue, ie a sale of shares by a company from treasury should be regarded as an issue of shares for the purposes of, for example, capital gains rollover relief on a takeover (section 135 of the Taxation of Chargeable Gains Act).

14 The Inland Revenue is considering the position for purchases and sales from treasury by Venture Capital Trusts and will be discussing this with representatives of the venture capital industry.

15 Views are invited on the proposed treatment of shares sold from treasury.

Stamp duty

16 Under current law, a repurchase of shares followed by cancellation is subject to 0.5% ad valorem stamp duty. A new issue of shares is generally free of stamp duty. It is proposed that a repurchase of shares without cancellation should be treated in exactly the same way as a purchase followed by cancellation, and that a sale from treasury should be treated like a new issue, ie that a repurchase of shares without cancellation should be subject to 0.5% stamp duty and a sale of shares from treasury will be free of stamp duty.

17 Views are invited on the proposed Stamp Duty treatment of repurchases of shares without cancellation and sales from treasury.

DRAFT REGULATORY IMPACT ASSESSMENT

THE COMPANIES (ACQUISITION OF OWN SHARES) (TREASURY SHARES) REGULATIONS 2002

Issue and objective

Under the Companies Act 1985, companies may purchase their own shares but only in the circumstances, and subject to the conditions, laid down in the Act. The purchase can only take place where authorised by a company's articles, and by the shareholders in a general meeting or by a special resolution. The shares must be fully paid up and, after the purchase, must be cancelled. In general, shares may only be purchased out of distributable profits or from the proceeds of a fresh share issue. However, this requirement is relaxed in respect of private companies which may also purchase their own shares out of existing capital as long as other requirements are met.

2 The objective of the regulations is to relax the requirement that a company that purchases its own shares is required to cancel them forthwith. The proposed regulations will allow certain companies that purchase their own shares the option either of holding them "in treasury" for resale at a later date or of cancelling them. This will be subject to the requirement that the aggregate nominal value of shares held in treasury must not at any time exceed 10% of the nominal value of the issued share capital of the company (or, where the company's share capital is divided into shares of different classes, 10% of each class). Certain other provisions will apply to shares held in treasury - for example, the voting rights applying to the shares will be suspended. However, since the regulations will provide a facility not currently available to companies they are deregulatory.

Risk assessment

3 In the context of both the existing law and the law as amended by the proposed regulations there is no perceived hazard or situation which would lead to any harm or detriment to any individual, company or organisation.

Issues of equity or fairness

4 For the vast majority of the 1.59 million companies on the register at Companies House and, indeed, a large majority of the 12,800 public companies on the register there will be no change to the law. The change to the law will apply only to the (less than 2,200) public companies defined in paragraph 7 below.

Benefits

5 Allowing companies the option of holding shares in treasury for resale, in addition to the option of cancellation, would give companies the ability to adjust their share capital to achieve optimum financial gearing without the costs of issuing new shares and might therefore lead to a reduction in companies' overall cost of capital. It could, as a result, stimulate investment. The purchase of own shares with cancellation already provides companies with the ability to increase the balance of debt to equity capital. However, many companies consider this mechanism too cumbersome for anything other than large step reductions in equity capital. Companies are reluctant to purchase their own shares if there is a risk that they may later have to incur the expense of issuing new shares. Companies would find it attractive to have the option of using their broker to resell treasury shares in small lots through the market at the full market price. This option would provide an alternative to other approaches such as rights issues and placings of shares which often involve significant underwriting costs.

Quantifying and valuing the benefits

6 The previous consultative document issued in May 1998 entitled "Share Buybacks" sought views on the costs and benefits of changing the law. All respondents to the consultative document who commented on this issue agreed that costs would be reduced but only one gave any estimate of the actual reduction in costs. One consultee commented that there would be obvious and undoubted cost savings from being able to issue shares from treasury and that since the company would not have had to signal to the market that it was selling shares well ahead of the money raising, the cost of capital would be significantly lower. Another consultee said that the proposals would enable UK companies to adjust their equity/debt mix in a cost effective manner in order to keep their weighted average cost of capital as low as possible. Currently, the cost and complexity of raising capital meant that companies did not adjust their debt/equity as frequently as they should. The proposals should lower the cost of capital. The one consultee who commented on costs estimated that the company could make savings of around £25,000 per annum.

Compliance costs for business, charities and voluntary organisations

Business sectors affected

7 The regulations, as currently drafted, would apply - with one exception - to all 2,200 public companies with shares that are quoted on the London Stock Exchange's main market or the Alternative Investment Market, and a small number of public companies with shares that are not quoted on either of these two markets but are quoted an equivalent of them in another EEA State. The one exception is investment companies (within the meaning of section 266 of

the Companies Act 1985) which would not be permitted to take advantage of the relaxed requirements of the law.

Compliance costs for a typical business/total compliance costs

8 The regulations will not impose any additional costs on business.

Consultation with small business

9 The regulations would apply only to the companies referred to in paragraph 7 above and would not, as a consequence, apply to small companies.

Results of consultation

10 The Department received a total of 72 responses to its consultative document "Share Buybacks" issued in May 1998. Of these, 53 supported a change to the law so as to allow repurchased shares to be held in treasury, six were opposed to a change, five were broadly neutral and eight offered no comments. A summary of responses was issued in October 1998 and sent to all respondents to the consultative document and anyone else who requested a copy. Kim Howells, then Parliamentary Under Secretary of State at the Department of Trade and Industry, announced in December 1999 that he had decided to deregulate company law in respect of the holding of shares in treasury and that further consultation would take place on the basis of draft regulations.

Summary and recommendation

11 There is clearly a consensus for change and it is recommended that company law be changed to permit companies meeting the description in paragraph 7 above to hold in treasury any shares that they purchase - subject to the limits set out in the draft regulations - and subject to the comments of consultees on the detail of those regulations. It should be noted that the view of consultees is being sought on whether investment companies should be allowed to hold shares in treasury.

Enforcement, sanctions, monitoring and review

12 Enforcement of the current provisions in the Companies Act 1985 - which are subject to criminal penalties for non-compliance - is the responsibility of the Department of Trade and Industry. The Department will be responsible for enforcing the amended law.

13 A wide ranging and fundamental review of company law came to an end on 26 July 2001 with the publication by the independent Steering Group of its final report and recommendations. At the same time, DTI's Ministers announced that, after considering the report in detail, they would consult on

draft legislation to reform company law. It is not possible to say when any such legislation would be introduced into Parliament; it would, however, offer the opportunity to amend the law applying to companies purchasing their own shares if, in the light of experience, this proved necessary.

CONSULTATION CRITERIA

1 Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.

2 It should be clear who is being consulted, about what questions, in what timescale and for what purpose.

3 A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.

4 Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others) and effectively drawn to the attention of all interested groups and individuals.

5 Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation

6 Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and the reasons for decisions finally taken.

7 Departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure the lessons are disseminated.

The complete code is available on the Cabinet Office's web site, address www.cabinet-office.gov.uk/servicefirst/index/consultation.htm.

COMMENTS OR COMPLAINTS

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to Mr A Dobbie, DTI Consultation Co-ordinator, Room 550, 1 Victoria Street, London SW1H 0ET or telephone him on 020 7215 6509 or email andrew.dobbie@dti.gov.uk.