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EMPLOYEE OWNERSHIP & SHARE BUY BACKS

Simple guide to the Companies
Act 2006 (Amendment of Part
18) Regulations 2013 & 2015

APRIL 2015

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Introduction

1. This short guide aims to explain to businesses and their representatives the changes to the share buy backs regulations within the Companies Act 2006 (Amendment of Part 18) Regulations 2013 and how these changes should be interpreted. Please note that the guidance was updated in April 2015, due to the enactment of related legislation, the Companies Act 2006 (Amendment of Part 18 Regulations) 2015. Guidance to the further changes can be found at [Annex A](#).
2. Companies using direct share ownership – where the shares are owned directly by the employees – will often seek to buy back shares from employees who are leaving or who have left the company in order to re-distribute them to new employees or new joiners to the share scheme. This is to avoid the risk that over time shares earmarked for allocation to employees become predominately owned by former employees or others outside the company.
3. Buy back arrangements may be discretionary and will depend on the departing shareholder (the seller) and the company (the buyer) mutually agreeing a price and/or arrangement, or the buy back might be compulsory under the terms of the employees' share scheme. Once a buy back is contemplated, companies must comply with a number of Company Law provisions that regulate the process.
4. The Nuttall Review concluded that some of these provisions are overly burdensome, and recommended that Government simplify them in order to remove barriers and disincentives to direct employee ownership.
5. The regulations implement that recommendation and are designed to make direct employee ownership more attractive and less burdensome to administer.
6. These deregulatory changes make it easier for companies that wish to pursue direct employee ownership to buy back shares from employees that leave the company, and so avoid the dilution of share ownership outside the company.

7. The provisions in the regulations are voluntary and impose no costs on business.
8. Since the law was enacted the Government was made aware of concerns about operation of the *de minimis* exemption.
9. As a result of this feedback, the Government considered additional legislative changes to Part 18 of the Companies Act 2006 (CA 2006) to further improve the operation of the regulations. Amendments to the 2013 legislation were introduced in April 2015. Guidance to the amendments can be found at [Annex A](#).

Summary of the April 2013 changes

10. The regulations simplify the company law provisions on share buy backs, as follows.

They:

- a) Allow shareholders in any company to approve off-market share buy backs by an ordinary resolution, i.e. a simple majority vote, and where such buy backs are connected with an employees' share scheme to allow for approval to be granted in advance.
- b) Give greater freedom for private limited companies so they can, if the seller agrees, pay in instalments for the shares they buy back in connection with an employees' share scheme.
- c) Make it simpler for private limited companies to finance share buy backs for employees' share schemes out of capital using a solvency statement and a special resolution.
- d) Enable shareholders to authorise directors of private limited companies to pay for small share purchases out of share capital without being subject to the procedures in Part 18 Chapter 5 (CA 2006)..
- e) Allow all companies limited by shares to be able to hold bought back shares 'in treasury'.

Benefits

11. The aims of these reforms are to:

- reduce the administrative burdens to administering share buy backs;
- increase the flexibility available to companies in how they administer share buy backs;
- remove barriers and disincentives to adopting direct employee ownership; and

- ultimately, to make employee ownership more attractive and thus more widespread in the economy, given its economic benefits.

Scope of the changes

12. The Nuttall Review identified a specific set of issues in relation to operation of share buy backs in connection with direct employee ownership. It is right, therefore, that these changes are mainly targeted at addressing those issues.
13. The regulations use the existing definition for employees' share schemes (section 1166 of the Companies Act 2006 (CA 2006)) rather than to attempt to create a definition of employee ownership for the purposes of company law.
14. In this context the phrase 'for the purposes of or pursuant to an employees' share scheme' relates to employee's share schemes using direct ownership where the shares are bought back from members of the company's employees' share scheme and/or are to be subsequently allotted from treasury to members of the company's employees' share scheme.
15. Where possible we have sought to bring the treatment of private companies and unlisted public companies in line with those of public listed companies. Public listed companies can already authorise market buy backs by a simple majority, using advance authorisation procedures, and hold shares in treasury. However, European Union company law limits the scope for extending some provisions surrounding share buy backs to public companies, such as buy backs out of capital.
16. We are conscious of the need to maintain a reasonable balance between the interests of shareholders – both those selling their shares and those that remain – and the interests of creditors. For this reason many of the changes are subject to specific shareholder approval, and a number of regulatory protections remain that protect the rights of shareholders and creditors in relation to share buy backs. These include director's duties (sections 171-177 of CA 2006) – including the duties to act within their

powers and to promote the success of the company – and the ability of shareholders to pass a special resolution to alter a company's articles of association to prevent, or set conditions on, share buy backs.

Authorisation of share buy backs

17. Off market share buy backs under Chapter 4 of Part 18 CA 2006 may be authorised by an ordinary resolution as described below.
18. However, if the off market share purchases are financed out of share capital in accordance with Chapter 5, each buy back must be authorised by a special resolution.
19. Share purchases out of capital using the *de minimis* exemption require specific authority in the articles of association (changes to the articles of association require a special resolution). Separate authority by ordinary resolution is required for the specific purchase (or multiple purchases) in question.

Individual buy backs

20. Allowing private limited companies and unlisted public companies to authorise share buy backs by ordinary resolution (a simple majority) rather than by special resolution (over 75% approval) should make it easier for companies to exercise the option to buy back their own shares. Public listed companies can already authorise market buy backs of shares through an ordinary resolution.

Multiple buy backs

21. Permitting the prior approval of multiple buy backs by ordinary resolution, where the purpose of the buy backs is connected with an employees' share scheme, will allow companies with employee ownership greater flexibility to buy back their own shares without incurring the costs of individually approving each contract.
22. The provisions that allow a 'standing authorisation' – the authorisation of share buy backs in advance (for buy backs connected to an employees' share scheme) are based on those that already exist for public listed companies (section 701 of CA 2006)

whereby the shareholders via ordinary resolution can set the parameters and conditions within which future buy backs may be approved without further shareholder approval.

23. These parameters include the maximum number of shares to be acquired, the minimum and maximum prices that may be paid, and a maximum time limit of 5 years, after which the authorisation will expire.

24. As with section 701 of CA 2006, a copy of the resolution granting a standing authorisation will need to be filed with the Registrar within 15 days. However, the authorisations of individual off-market share buy back contracts do not need to be filed with the Registrar.

Payment by instalments

25. The Government recognises there are circumstances when for some companies, particularly smaller companies, it can be difficult to afford to buy back shares from a selling shareholder or shareholders upfront.

26. The Government sees allowing payment by instalments as a practical step to enable companies that may be unable to repurchase the shares upfront the flexibility to finance the purchase of their own shares over a longer period. However, we do not foresee that this will become the default method for the buy backs of shares, particularly where the company can afford to pay for the shares upfront.

27. The buy back of shares generally is a voluntary agreement between the company and the selling shareholder. The use of payment by instalments will require the agreement of both the selling shareholder and the company, either at the time of sale, or as defined in the contract.

28. The Government believes that the time period for the buy back of shares should be a matter of negotiation for the two parties concerned, and not be dictated in statute. This view was supported by the consultation responses. Indeed, as a number of the

consultation respondents pointed out, there is no statutory time limit on the redemption of shares.

29. Employees should be made aware of their rights and the buy back process should allow time for employees to obtain independent legal and/or financial advice should they consider it necessary.
30. If a company is insolvent, shareholders will likely receive very little, if any, return on their investment. Former shareholders who are owed money for the sale of their shares to the company will be unsecured creditors, and are therefore slightly more likely to receive some return in the insolvency.

Share buy backs out of share capital

31. The Government takes the view that the regulatory requirements for buy backs out of share capital should be proportionate to its purpose, such as in connection with an employees' share scheme, and the number and/or values involved. Thus, the Government has introduced reduced regulatory requirements for buy backs out of share capital for the purposes of or pursuant to an employees' share scheme under Part 18 Chapter 5 (s720A CA2006), and a *de minimis* exemption from the requirements of Part 18 Chapter 5 (s692(1)(b)).
32. The provisions relating to buy backs out of share capital in accordance with Chapter 5 (s692(1)(a)) and relating to buy backs out of share capital using the *de minimis* exemption from the requirements of Chapter 5 (s692(1)(b)) may be either applied separately or in tandem according to the needs of the company at the time of the buy back.

The reduced regulatory requirements under Part 18 Chapter 5

33. The Government has taken note of responses to the consultation that called for a simplification of the process for purchasing shares out of capital and pointed to the simplified regulations that exist elsewhere in company law relating to capital reduction.
34. These changes will allow companies buying back shares out of capital in connection with an employees' share scheme to choose whether to be subject to the reduced regulatory requirements (s720A), or to the pre-existing Chapter 5 requirements.
35. The reduced regulatory requirements consist of a special resolution supported by a solvency statement and statement of capital. It is based on the existing provisions relating to the reduction of capital (section 642-643 of the Companies Act 2006).
36. Once the resolution authorising the purchase of the shares has been passed, the seller may then surrender (return) the shares back to the company. Payment for the shares must take place between 5 and 7 weeks from the date the shares are surrendered, subject to any court action under s721 (which allows a 5 week period from the date of the resolution in which a member of the company or a creditor may apply to court for an order to prevent the payment).

The *de minimis* exemption

37. The Government takes that view that the buy back of very small amounts and/or a low value shares out of share capital could be made subject to fewer restrictions without constituting a significant risk to the company, or its shareholders or creditors. Nonetheless, this method for financing is only available to companies, if authorised to do so by the articles of association.
38. The aim of the *de minimis* exemption is to allow shareholders to authorise a company to buy back small amounts of shares by number and/or value out of share capital without being subject to the permissible capital payment provisions in Part 18 Chapter 5 CA 2006.

39. Any shares bought back using the *de minimis* exemption must be purchased at their nominal value as the regulations do not provide for the treatment of shares bought either at a premium or at a discount (in other words at more or less than the nominal value of the shares). The total amount payable in any financial year must be the lesser of £15,000 or the cash equivalent of 5% of aggregate nominal value of the company's share capital.
40. Companies using this mechanism must calculate what the 5% level is. The regulations are not prescriptive about how and when the calculations should be made. The onus is on the company concerned to ensure that neither the 5% level nor the £15,000 limits are exceeded particularly where multiple buy backs occur during the financial year.
41. One method for calculating the 5% level where a company is intending to undertake multiple buy backs during the same financial year could be to calculate the 5% level at the start of the financial year and to use this as the reference point for buy backs undertaken during that year.
42. Please see Annex A for further update.

Treasury shares

43. Listed public companies can already hold their shares 'in treasury' (a share 'storage facility') so that they may be re-issued at future date, rather than cancelling the shares and issuing new shares. The Government sees no reason why private limited companies and unlisted public companies should not be able do likewise.
44. However, only shares bought back from distributable reserves or out of share capital using the *de minimis* exemption may be held 'in treasury'. Other shares bought back from out of share capital or from a fresh issue of shares are cancelled in order that the share capital reflects the shares issued on the balance sheet.

45. The remaining provisions relating to treasury shares are unchanged. Therefore, the provisions in relation to treasury shares are consistent between the different types of companies limited by shares and contain the same protections, e.g. preventing companies from exercising voting rights attached to shares held in treasury.

Further changes to the regulations

46. After the regulations came into force we received feedback on how the regulations might need to be amended. In response to this feedback the Government proposed to consult on further minor legislative changes in relation to:

- a) The *de minimis* exemption – To clarify the operation of the *de minimis* exemption in law including the treatment of shares bought back using the *de minimis* exemption where the shares are bought back at a premium or at a discount; and to consider whether allowing shares which are bought back using the *de minimis* exemption to be held in treasury is consistent with normal accounting practices and the treatment of other buy backs out of capital.
- b) The reduced regulatory requirements for buy backs out of share capital – To consider how the timing of the surrender and payment of shares could be simplified.

Please see **Annex A** for amendments to Regulations in line with feedback to our informal consultation.

The Post Implementation Review

47. In addition to the legislative changes being considered above, it remains the Government's intention to conduct a full Post Implementation Review of these regulations – The Companies Act 2006 (Amendment of Part 18) Regulations 2006 – three years after enactment.

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48. As detailed in the Government response to the share buy back consultation, the review will focus on whether or not each of the provisions in this regulation have been effective, and whether there have been any unintended consequences.

49. It will also examine any demand for further legislative changes.

50. In addition it will examine any available evidence on monetised and non-monetised costs or benefits arising from these measures.

51. In the meanwhile any feedback and evidence may be submitted to the Department via the Employee Ownership inbox: employeeownership@bis.gsi.gov.uk.

Annex A:

Companies Act 2006 (Amendment of Part 18) Regulations 2015

Introduction

This Annex aims to explain the amendments introduced by the Regulations of 2015, to the share buy-back Regulations of 2013, and sets out the changes made.

The 2015 Regulations are a continuation of the changes brought in by the 2013 Regulations; this note should be read in conjunction with the 2013 guidance.

Surrender of shares bought back under section 720A Companies Act 2006

1. Regulation 6 amends section 723 to provide for shares that are purchased under section 720A (reduced requirements for payment out of capital for purchase of own shares for the purposes of or pursuant to an employees' share scheme) to be surrendered no earlier than five weeks after the date on which the resolution under section 720A is passed and no later than seven weeks after that date.
2. Section 723 as amended no longer provides for when a payment must be made for shares purchased under section 720A. This change allows a company to take advantage of the opportunity to defer payment, which is available to companies where the purchase of shares is for the purpose of an employees' share scheme, under section 691(3).
3. It is considered important to continue to have time limits for the surrender of the shares however, to ensure that companies cannot effectively have a number of shares that are cancellable at will. Section 723 as amended therefore sets time limits for the surrender of shares by reference to the resolution for the buy back.

The *de minimis* exemption

4. Regulation 3 amends section 692 to clarify that subsections s692(1)(a) and s692(1)(b) do not need to be applied together, and may be applied together or separately.
5. Regulation 9 amends section 734 to clarify that buy backs under section 692(1)(b) should be accounted for in the same way as a buy back in accordance with Part 18 Chapter 5.
6. It should be noted that this means that the purchase price of a buy back under section 692(1)(b) does not have to be the nominal value - it could be more or less. This is because section 734 (as amended by Regulation 9) ensures the price is treated essentially the same as for a permissible capital payment made under Chapter 5; per section 734(1A), “permissible capital payment” is read as a reference to the actual purchase price rather than the nominal value (if different). Section 734(3) sets out where any difference between the nominal value and actual purchase price is written off.
7. As a consequence, **paragraph 39** of the 2013 guidance is no longer correct for shares bought back under this process.

Treasury shares

8. Regulation 7 ensures that the treatment of buy backs out of capital, whether under the *de minimis* exemption or Part 18 Chapter 5 are consistent and would not result in potential accounting anomalies such as phantom profits.

Statements of capital

9. Regulation 4 ensures that a company does not have to deliver a statement of capital under both section 708 and 720B where the two would be identical.
10. It should be noted that the Small Business, Enterprise and Employment Act 2015 makes changes to the requirements of statements of capital. These can be found in sections 97 and 98 and Schedule 6 of that Act.

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Post Implementation Review

It remains the Government's intention to conduct a full Post-Implementation Review of the Companies Act 2006 (Amendment of Part 18) Regulations 2013, in 2016, which will be three years after enactment. The Review will include the amendments made in 2015

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BIS/15/288