EXPLANATORY MEMORANDUM TO

THE COMPANIES ACT 2006 (AMENDMENT OF PART 17) REGULATIONS

2015 No. 472

1. This explanatory memorandum has been prepared by the Department for Business, Innovation & Skills and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument amends the Companies Act 2006 to prohibit a company from reducing its share capital using a scheme of arrangement in connection with the takeover of that company.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The Companies Act 2006 contains the main statutory basis for UK company law and corporate governance. Part 17 governs a company's share capital, including provisions relating to the reduction of capital.

4.2 The instrument amends section 641 of the Companies Act 2006 using the power in section 657 of that Act to restrict the ability of a company to reduce its share capital as part of a scheme of arrangement by virtue of which a person would acquire all the shares, or all the shares of a particular class, in that company. The acquisition may relate to a person acting alone, or together with its associates. The prohibition does not apply to schemes of arrangement where there is no substantial change in the ultimate shareholders in the company.

4.3 The instrument contains a transitional provision that restricts the application of the Regulations to takeovers announced on or after the date that the Regulations come into force, or where the offer is not subject to the Takeover Code, to takeovers where the terms are agreed between the parties on or after the date that the Regulations come into force.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 Jo Swinson MP, Minister of State for Employment Relations and Consumer Affairs has made the following statement regarding Human Rights:

In my view the provisions of the Companies Act 2006 (Amendment of Part 17) Regulations 2015 are compatible with the Convention rights.

7. Policy background

- What is being done and why

7.1 Takeovers and mergers are given effect either by a contractual offer to the target company's shareholders to purchase their shares, or by means of a scheme of arrangement, a long established court sanctioned process for making changes to a company's share or debt structures.

7.2 In the context of takeovers, there are two main types of schemes of arrangement: a 'transfer' scheme sees the transfer of shares in the target company to new owners; a 'cancellation' scheme sees a reduction of the target company's share capital (as governed by Part 17 of the Companies Act 2006) and the issue of new shares to the new owners. Stamp taxes on shares[1] are charged on the transfer of shares but not on the issue of new ones. So implementation of a 'transfer' scheme requires payment of tax (at 0.5% of the consideration paid for the shares), but no such liability flows from implementation of a 'cancellation' scheme.

7.3 Takeovers of UK public companies are increasingly being carried out via "cancellation" schemes of arrangement, thus not incurring the stamp taxes on shares liability. The Government believes that all takeovers should be treated equally in tax terms, and is therefore taking action to close what is effectively a tax loophole. This is being achieved through a targeted amendment to section 641 of the Companies Act 2006 that will prevent a company from reducing their share capital alongside a "cancellation" scheme of arrangement to facilitate its takeover. It will still be possible to effect a takeover by means of a 'transfer' scheme of arrangement.

7.4 The Government recognises that there are other situations where a scheme of arrangement and/or a reduction of capital may be appropriate such as intra-group restructuring, de-mergers, rescheduling debt, or returns of capital. This instrument therefore includes a specific exemption for circumstances where the acquisition amounts to a restructuring that inserts a new holding company into the group structure, where the shareholders of the new holding company have not changed substantially from the shareholders of the company undertaking the scheme of arrangement.

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[1] In this Memorandum the term 'stamp taxes on shares' is used as shorthand to describe the two types of transaction tax arising on shares: 1) stamp duty reserve tax (paid on electronic share transactions); and 2) stamp duty paid on transactions in material or non-electronic shares if the transaction is over £1,000. In both cases a tax or duty of 0.5% of the transaction is usually payable.

7.5 The Government is also not seeking to impact on takeovers that are already in progress. For this reason this instrument includes transitional provisions so that companies that have made an announcement of a firm intention to make an offer (in accordance with the Takeover Code) before the date this instrument comes into force will not be captured by the regulations. Likewise, offers not subject to the Takeover Code will not be affected if the terms of the offer have been agreed before the date this instrument comes into force.

7.6 The Government has considered other policy options such as levying a tax charge directly to "cancellation" schemes of arrangement when used to facilitate a takeover. This option was rejected due to legal constraints arising from the EU Capital Duties Directive (2008/7/EC) which prohibits the taxation of the new issue of shares. The Government also considered equalisation of the tax treatment by removing stamp taxes on shares on "transfer" schemes of arrangement but rejected this option due to the negative impact this would have on government revenue. In addition the Government rejected the 'Do Nothing' option as this would fail to close the tax loophole.

- Consolidation

7.7 Consolidation with previous orders or regulations is not relevant. The instrument amends only one section of the Companies Act 2006 that has had one minor amendment (the High Court and County Court Jurisdiction (Amendment) Order 2014, S.I. 2014/821) and has not otherwise been amended, and so the Department for Business, Innovation & Skills has no plans for consolidation at this time.

8. Consultation outcome

8.1 The Government has consulted informally with relevant experts over the policy and detail of the proposed legislation, but has not conducted a formal consultation. The Government wishes to put legislation in place as soon as possible, so as to limit the scope for companies to bring forward takeovers or mergers specifically in order to circumvent the legislation.

9. Guidance

9.1 We do not intend to provide specific guidance given that these changes are sufficiently explained in the Explanatory Notes.

10. Impact

10.1 The impact is limited to companies that are parties to a takeover or merger, their shareholders and creditors, and their advisers. Companies considering a "cancellation" scheme of arrangement to effect a takeover will still be able to do so through a "transfer" scheme of arrangement or by a contractual offer. The Government considers that the inability in future to structure around stamp taxes on shares through using a cancellation scheme is unlikely to have any significant impact on companies' decision of whether or not to pursue takeovers or mergers given the large value of such transactions and the

relatively small amount of stamp taxes on shares payable in relation to the overall value. Other than the payment of the applicable stamp taxes, the main impacts will be one-off familiarisation costs for stakeholders listed above and for the intermediary community such as legal firms and advisors specialising in takeover and scheme of arrangement activity. The Government assesses that that these familiarisation costs are likely to be small.

10.2 This instrument will not result in any direct impact on the public sector.

10.3 Consistent with the approach adopted for measures affecting the tax base, an Information and Impact Note is attached to this memorandum and will be published alongside the Explanatory Memorandum.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 In principle this instrument applies to businesses of all sizes. However, in practice, schemes of arrangement in takeover situations tend to involve larger companies, and in particular listed companies and the likely impact on small businesses will be minimal. In addition, the measures in this instrument aim to ensure the appropriate payment of tax and therefore the Government is of the view that no mitigation in favour of any type of business including small businesses is necessary.

11.3 Individual businesses have not been consulted. However, none of the experts consulted privately expressed concerns about the impact of any costs arising from the measures proposed on small businesses.

12. Monitoring & review

12.1 The Department for Business, Innovation & Skills will undertake a post-implementation review within five years of implementation to assess the impact of the legislative changes made, and whether alternative mechanisms that structure around stamp taxes on shares have been found / are being used. The results of the review will be published on the GOV.UK website.

13. Contact

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